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AUDIT TENURE AND FINANCIAL REPORTING QUALITY: A STUDY OF LISTED NON-FINANCIAL FIRMS IN NIGERIA

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Abstract
The study ascertained the effect of audit tenure on the financial reporting quality of listed non-financial firms in Nigeria. Ex-Post Facto research design was deployed in the study while the sample size is 23 listed non-financial firms. Data were collected from the annual reports of the purposive sample over a ten year period 2012 to 2021. Both descriptive and inferential analyses were carried out in the study. Ordinary Least Squares were used to estimate in the regression coefficients with which the null hypothesis was tested at 5% significance level. The findings revealed that audit tenure has a positive but non-significant effect on the quality of accruals of listed non-financial firms in Nigeria at 5% alpha level. The study recommends that given that the benefits of longer audit tenure may be offset by the risks of familiarity and complacency, companies should consider limiting audit tenure to enhance independence and objectivity. Regulators may also consider implementing mandatory audit rotation policies to reduce the risks of familiarity and bias.

Keywords: Audit tenure, Financial reporting quality and Non-financial firms

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Introduction

Auditor independence means the independence of the internal auditor or external auditor from parties who may have a financial interest in the audited business. Audit report issued by the auditor. Audit independence also refers to the likelihood that the auditor will discover and report violations of the accounting system. The concern about the independence of the auditor is very important for his financial credibility and that was the reason why market regulators are more concerned about the independence of the auditor so that they can provide a high international standard of audit quality that auditors can trust users of financial statements (Dattin, 2017; Velte and Loy, 2018, cited by Yakubu and Williams, 2020). Albeksh (2017) defined audit independence as the ability of the auditor to maintain an objective and unbiased mental view, to be neutral during the audit, to analyze the results and confirm in the prepared audit report. The independence of the auditor has long been considered a cornerstone of the auditing profession and is a privilege of self-direction. Investors analyze financial reporting as the main source of information to determine the financial situation of the company. The Securities and Exchange Commission approved a new auditor independence provision that requires publicly traded companies to disclose the amount of fees paid to their external auditor for non-audit services (IAASB, 2015). Ensuring auditor independence is a top priority not only for auditors, but also for management and investors. In today's global market there is government, creditors, institutional investors, lenders, regulators, stakeholders etc. Rely on the information provided by auditors on the credibility and reliability of financial statements (Ayowale, 2019). Financial reporting quality refers to the reliability of the auditor's opinion on the financial statements. The quality of financial reporting is usually improved when auditors are completely independent in their work. The main purpose of preparing financial statements is to provide useful information for making financial decisions and to enable the auditor to express an opinion on whether the financial statements have been prepared in all material respects in accordance with auditing standards.

Improving the quality of reporting provides investors with more accurate information and thus can reduce information asymmetry and increase contractual efficiency (Ayowale, 2019). Thus, improving the quality of reporting can improve a company's chances of obtaining external financing and ultimately lead to an increase in investment and investment efficiency (Ayowale, 2019). The auditor must conduct a systematic review of the client's accounting system and determine to what extent investors can trust the financial statement, and also communicate to management the area that needs greater attention. The International Federation of Accountants (IFAC) identifies five threats to auditor independence: self-interest, self-evaluation, lobbying, familiarity and intimidation; all this shaped the involvement of auditors.

The independence of the auditor and the services provided are considered the cornerstone of audit quality. It is an integral part of the financial reporting process and a prerequisite for adding value to all audited financial statements. This, in turn, facilitates obtaining an acceptable audit opinion as the final product of the audit engagement. Audit independence is an important part of auditing practice. However, there is a consistent concern to consider all the variables that can impair the auditor's independence when considering the quality of the audit report provided. These variables include audit fees, audit office and provision of non-audit services. Fees paid to the auditor may interfere with the auditor's independence and tempt the auditor to violate the auditing standard, which may impair the quality of the financial report. Consequently, researchers such as Babatolu et al. (2016); Maria (2016) suggests that the amount paid for auditor services is often a barrier to auditor independence, as higher audit fees are likely to increase the financial bond between the auditor and the auditee, which weakens the auditor's independence (Fiitriany, Sylvia, & Viska). , 2016), while an audit firm charging low fees can influence the institution's management, which may decide to offer the auditor more money to undermine his professionalism and thus hinder his independence. This study therefore sought to determine the effect of audit fees on the quality of accruals of listed non-financial firms in Nigeria.

Conceptual Review

DeAngelo (1981) defines auditor independence as the auditor's balanced mental judgment in making decisions during the conduct of an audit and in disclosing the results of such an audit. In this context, independence is a means by which the auditor demonstrates that he can perform his duties objectively (Aliu, 2018, Agbaje, Sadiq, Adesoji and Oyindamola2021). If the auditor's independence is compromised, the auditor is likely to be biased. It follows that the inspector is not considered independent to report the violations found. In this regard, the independence of the auditor is the parameter based on which the quality of the financial report can be better evaluated. Mautz and Sharaf (1961) developed two types of auditor independence, namely practitioner independence (or independence in fact) and professional independence (or independence in appearance). The auditor's code of ethics defines independence as a state of mind that allows conclusions to be drawn that are free from influences that impair professional judgment, enabling the individual to act with integrity and show objectivity and professional skepticism (IFAC, 2009). Audit duration is the length of the audit client relationship, measured in years. An audit period is an audit task between an audit firm and a client related to pre-agreed audit services, and an audit period can also be interpreted as the duration of the relationship between an auditor or an audit firm and their clients while performing audit work, measured by the number of consecutive years (Cholifah, Ambar and Sri, 2022). There are two debates about the relationship between accounting and earnings management. The first argument indicates that an unreasonably long auditor-client relationship threatens the auditor's independence due to closer relationships and familiarity with the client. Long tenure of auditors, on the other hand, are advocates of longer tenure of auditors who argue that it increases auditing efficiency and experience by extending the relationship between the auditor and the client. This makes auditors more effective in uncovering questionable accounting practices from the client than in the early years of the audit engagement. Another argument suggests that longer auditor tenure is likely to be associated with less earnings management in firms (Aondoakaa, Kwaghfan, & Achika, 2022). Extending the auditor's tenure may increase the auditor's knowledge of the client's internal operations, but it may also jeopardize the auditor's independence (Islamo, 2016; Feleke, 2017). Clients, on the other hand, shift auditors for a variety of reasons, one of which being a reduction in audit fees from the new auditor, who may offer services at a discount to entice new clients (Oladipupo & Emina, 2016 as cited in Aondoakaa et al, 2022).

Empirical Studies

Adesola (2021) in his study investigated the effect of auditor independence on the quality of financial reporting of parastatals in Lagos State, Nigeria. In order to collect information about the independence of the auditor, a survey was conducted and a content analysis was conducted to extract secondary information from the financial statements of the Polish public auditor. Data were analyzed using binary logistic regression data extract from the 2014-2019 audited financial statements of the 63 states in Lagos State. The results show that when the auditor surrenders a personal interest in the audit and his ability to issue a qualified audit opinion when necessary, it has a statistically significant effect on improving both basic and advanced financial reporting quality attributes (FQC and EQC). Therefore, the more an auditor allows his personal interests to cloud his judgment, the lower the FQC and EQC of financial reporting. The result of trust in the work of internal auditors and auditor rotation gave an inconclusive result. Therefore, auditor rotation and reliance on the findings of internal auditors contribute to the meaning and truth of financial reporting, while EQC does not affect auditor independence. The study recommended that SOEs invest in promoting auditor independence to minimize audit failures and credibility related to financial statements. In their study, Oluyinka, Adeleke and Olugbodi (2020) investigated the effect of audit quality on financial reporting quality of listed depository banks in Nigeria. The information is taken from the audited annual reports of all 11 listed savings banks in Nigeria for the ten year period 2009-2018. The study used panel multiple regression and the Hausman test to choose between a random and fixed effects model. A random effects model was selected and interpreted. They found that audit firm size, audit time, and audit fees affect financial reporting quality (FRQ), but only the effect of audit fees was statistically significant. Unlike many previous studies, this study used financial statement importance, based on the time between the end of the financial year and the date when the report was signed by the external auditor, to measure the quality of financial reporting. In their study, Owolabi, Afolayan and Oluwatobi (2020) assessed the impact of AUDINDP on FRQ quality in listed DMBs in Nigeria. The need for auditor independence is essential to complete the audit reporting process. The auditor's autonomy is also manifested in technical, research and reporting practices. In order for an audit report to publicly demonstrate that it is a true picture of things, the auditors must be absolutely independent. The population of this study consisted of 20 DMB listed in Nigeria. Purposive non-probability sampling was used to select a sample of ten (10) banks. Secondary data was also adopted and collected from the certified annual report of the sampled DMBs. Descriptive tests, correlation analysis and panel OLS regression were used for analysis. The study showed that there is a positive relationship between DMB AUDINDP and FRQ. AUDINDP is an important audit quality in financial reporting. Auditors and auditors must adhere to the integrity of independence to achieve the credibility and reliability required of financial reporting. Okezie and Egeolu (2019) investigated the effect of audit independence on the reliability of financial statements in the banking sector. An ex post facto research design was employed and data was collected from four (4) listed banks in Nigeria also operating in the African region. Data from the five years 2014-2018 were analyzed using multivariate linear regression. The results showed that audit independence had a significant effect on the value relevance of the financial statements of the studied banks. This was reflected in the fact that the amount spent on the audit fee did not have a significant impact on the published earnings per share (comparison of investor confidence in financial statements). Additional findings indicate that audit independence has an insignificant effect on the timeliness of financial statements. Banks and other firms were advised to negotiate reasonable audit fees that would ensure the authority of an independent audit firm; Increase the reliability of the presented financial statements and thus create a high reliability of the financial statements. In addition, directors must work independently with the auditors to ensure the timely preparation of financial statements that can indicate reliability. Olagunju and Adebayo (2011) critically assessed auditor independence and analyzed the importance of auditor independence on the reliability of financial statements. In order to make an informed decision, it is important that the financial statements are reliable. Relevant data collected were analyzed using simple percentages and tables and tested using chi-square. The test results show that auditor independence affects the reliability of financial statements, and improving the reliability of financial statements can reduce manipulation in financial statements. The reason an audit exists is that investors and creditors can use financial statements to make decisions. The study concluded that the independence of auditors and the reliability of financial statements are significantly reduced in the provision of non-audit services, and that there is a positive relationship between auditor independence and the reliability of financial statements, thus auditor independence is critical to the reliability of financial statements. Adeyem and Okpala (2011) investigated the effect of audit independence on financial reporting in Nigeria. The objective of the study was to investigate, explore and verify the interaction between audit quality and corporate financial reporting in Nigeria. Thus, the study is a move towards improving the quality of audit practice in Nigeria. Both primary and secondary data were used to conduct this study. The survey gathered opinions from respondents including auditors, shareholders, brokers, analysts, regulators, management, researchers and other users of financial information. Primary data was obtained from three hundred and fifty returned and usable questionnaires, while secondary data was obtained from the financial statements of the annual reports of forty listed companies in Nigeria. The collected data were used to test the research hypotheses and answer some research questions. During the study, a significant and positive relationship was found between audit quality and financial reporting quality. Made, Rencana, Nyoman and Luh (2020) investigated the effect of auditor independence on audit quality and the effect of audit fees on audit quality, the effect of audit time on audit quality. The data type used is a questionnaire. All auditors working at an audit firm in Bali are included in this study. Sampling is done by simple random sampling, which can be analyzed with up to 87 respondents. Data analysis was performed using multiple regression analysis. The test results show that (1) auditor independence has a significant effect on audit quality. It was also revealed that audit fees have a significant impact on audit quality; also, the duration of the review does not significantly affect the quality of the review.

METHODOLOGY

This study used an *Ex-post-Fact* research design to determine the effect of audit independence on financial reporting quality of listed non-financial companies in Nigeria. This makes the design suitable for this study because the quality of financial reporting and audit independence already existed between 2012 and 2021, and the study goes back in time to examine their relationship.

Purposive sampling technique was used to select the sample size. This approach involves selecting members of the population based on certain characteristics. The three attributes used in this study were that the non-financial company must be in either the consumer goods or industrial products industry, be listed on the stock exchange since the financial year 2012, and submit full annual reports to the Nigerian Stock Exchange Group from 2012 until 2021. Information was collected from annual reports and financial statements of Nigerian listed companies for a 10-year period (2012-2021). Information is obtained from the Nigerian Exchange Group (NGX) website and other relevant sources.

Method of Data Analysis

The data collected are analyzed using descriptive statistics to summarize the data and inferential statistics such as Ordinary Least Square regression analysis to determine the relationship between the dependent and independent variables. The regression analysis was used to test the specific objectives of the study. OLS was adopted because of its “BLUE” property: "Best Linear Unbiased Estimators". In the context of OLS regression, BLUE refers to the fact that OLS regression produces the best linear unbiased estimates of the regression coefficients (also known as "parameters") in the model. This means that the estimates are unbiased, meaning that on average, they equal the true values of the parameters, and they have the smallest variance among all linear unbiased estimators.

Model Specification

The moderated linear model using Audit Status is stated below:

$ACQ_{it} = \beta_0 + \beta_1 AUDF_{it} + \beta_2 PNAS_{it} + \varepsilon_{it}$ ____________________eqn (i)

Where,

ε_{it}	=	error term for firm i in period t.
β_0	=	constant.
β_{1-2}	=	parameters
ACQ_{it}	=	Accruals Quality for firm i in period t.
$AUDT_{it}$	=	Audit Tenure for firm i in period t

Decision Rule

The study adopted 5% level of significance in the inferential statistical analyses. If the test statistic has a p-value below the chosen threshold ($p < 0.05$) then the null hypothesis is rejected and while the alternate hypothesis is accepted; and vice versa.

Data Analysis and Results

Table 1 Descriptive Statistics

	ACQ	AUDT	PNAS
Mean	-1787841.	3.980583	0.587379
Median	-1130075.	4.000000	1.000000
Maximum	51917058	10.00000	1.000000
Minimum	-73557289	1.000000	0.000000
Std. Dev.	16406433	2.221758	0.493505
Skewness	-0.821657	0.690637	-0.354977
Kurtosis	9.680270	2.793512	1.126009
Jarque-Bera	406.2191	16.74226	34.46962
Probability	0.000000	0.000231	0.000000
Sum	-3.68E+08	820.0000	121.0000
Sum Sq. Dev.	5.52E+16	1011.922	49.92718
Observations	206	206	206

Source: Analysis Output (2023) Using Eviews 10

The cumulative quality (ACQ) mean is -1787841, indicating that this variable has a negative mean. The average ACQ value is -1130075, which is below average. This indicates that the distribution of this variable is skewed to the left. The maximum value of ACQ is 51917058, which is much higher than the mean and median.

Audit duration (AUDT) has a mean close to 4 and a median of 4, indicating that the data are fairly evenly distributed. The standard deviation is small, indicating that the data are not spread out. The skewness is slightly positive, indicating that the data is slightly skewed to the right. Kurtosis is moderate, indicating that the spread is somewhat peaked. The Jarque-Bera test suggests that the distribution is significantly different from the normal distribution. The amount is relatively small, indicating that the total value of the variable is not very large.

Hypothesis

H_0: Audit tenure has no significant effect on the quality of accruals of listed non-financial firms in Nigeria.

Table 2 Ordinary Least Square Regression Analysis
Dependent Variable: Accrual Quality
Method: Pooled Least Squares
Date: 02/24/23 Time: 14:40
Sample: 2012 2021
Periods included: 10
Cross-sections included: 23

Variable	Coefficient	Std. Error	t-Statistic	Prob.
AUDT	412459.7	596781.5	0.691140	0.4903
C	-3781491.	4717844.	-0.801529	0.4238

R-squared	0.038085	Mean dependent var	-1787841.
Adjusted R-squared	0.009082	S.D. dependent var	16406433
S.E. of regression	16331759	Akaike info criterion	36.08851
Sum squared resid	5.31E+16	Schwarz criterion	36.20159
Log likelihood	-3710.117	Hannan-Quinn criter.	36.13425
F-statistic	1.313155	Durbin-Watson stat	1.263216
Prob(F-statistic)	0.252810		

Source: Analysis Output (2023) Using Eviews 10

The regression analysis above predicted Accrual Quality using: Audit Fee (AUDF), and Audit Tenure (AUDT). The R-squared value of 0.038085 suggests that the model explains only a small proportion (3.81%) of the variation in Accrual Quality, and the adjusted R-squared value of 0.009082 indicates that the model may not be a good fit for the data. The F-statistic of 1.313155 and Prob(F-statistic) of 0.252810 further support this notion, implying that the overall significance of the model is weak.

The coefficient for Audit Tenure is 412459.7, which means that an increase in AUDT by margin enhances accrual quality by 412459.7. However, the t-Statistic is only 0.691140, which is not statistically significant at a 5% level of significance. The Prob. value of 0.4903 is also greater than 0.05, suggesting that the null hypothesis is accepted while the alternate hypothesis is rejected.

Having accepted the null hypothesis, audit tenure has a positive but non-significant effect on the quality of accruals of listed non-financial firms in Nigeria at 5% alpha level.

CONCLUSION AND RECOMMENDATION

The positive effect of the audit period on accrual quality means that a longer audit period can lead to a better understanding of the client's activities, which can improve the quality of financial reporting. However, the nonsignificant effect indicates that the benefits of a longer audit period may outweigh the risks associated with familiarity and complacency, which may compromise the independence and objectivity of the audit team. This result is relatively similar to Made, Rencana, Nyomani, and Luh (2020); Oladejo, Abiodun and Oyebamiji (2020); Lambe, Orbunde and Yohanna (2021) but refuted the finding of Babatolu, Aigienohuwa and Uniamikogbo (2016) and Augustini, Theresa and Chukwuemeka (2021) that audit period is negatively related to financial reporting quality. In conclusion, the study finds that audit tenure has a positive impact on the quality of financial reporting of listed non-financial companies in Nigeria. These results highlight the importance of maintaining auditor independence and objectivity in improving the quality and reliability of financial reporting. Given that the benefits of a longer review period may be offset by the risks of familiarity and complacency, companies should consider limiting the review period to increase independence and objectivity. Regulators may also consider establishing mandatory audit rotation practices to reduce the risks of familiarity and misrepresentation.

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