

THE EFFECT OF AUDIT TENURE AND NON – AUDIT SERVICES ON AUDITORS NEGLIGENCE: A STUDY OF NIGERIA

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ABSTRACT

The research work examined the impact of audit tenure and non – audit services on auditors negligence. Failure to report certain weaknesses because of the auditors’ negligence in his reports to management often affect the performance of corporate organizations negatively. The specific objectives are: to determine whether audit tenure influences audit negligence, to determine whether non – audit services provided by auditors to its client lead to audit negligence, and to ascertain whether interaction of audit tenure and non – audit service lead to auditors negligence. Business analysts, Investors and Academia were used. Survey design was adopted for this study. Copies of questionnaires were administered to 115 sample respondents. Analysis of variance (ANOVA) was used to analyze data collected statistically at 5% or 0.05 level of significance , and in testing the hypotheses; Regression analysis was used, with the aid of statistical package for social sciences (SPSS) 20.0 soft ware. The test showed that lengthy audit firm tenure lead to audit negligence. The researcher recommends that the auditing profession to make significant regulatory pronouncement in this regard. Accounting and auditing profession is advised to come up with a policy on auditors performing non – audit services to its client. Consequently, auditors should put their own professional code of practice above their clients’ organizational culture which prioritized high profits.

1. INTRODUCTION

The managers of business are obliged to report to the owners of the business on how their business has been managed. The owners, at this point, will like to assure themselves that the report contains no material errors that can affect their business decision and it discloses all relevant information. To protect the credibility of company financial report, owners of business are empowered by Companies and Allied Matters Act (CAMA) 2004 to appoint an independent person, referred to as an auditor, to investigate the report and express his opinion on it. Despite that auditor was appointed to lend credibility to business financial report, it is noted that auditor reports to management often affect the performance of business negatively. This was attributed to auditors been negligence on their duty.

Webster's New College Dictionary (2005) said, negligence is to exhibit a lack of due care or concern, or to fail to care for or give proper attention. According to Adeniyi (2015), auditors are expected to demonstrate some professional skills and competence, uphold professional ethics, fairness, due care among others. General Cotton Mill (1896) case cited by Nweke, Ekwueme and Okoye (1997) said, the auditor owes a duty of a reasonable standard of skill, care and caution to his client, because he has a contractual relationship with him. If his performance falls below a reasonable expected standard, he will be liable in damages to his client who suffers financial loss as a result of his negligence. Adeniyi (2015) opines that the bankruptcy of Enron in 2001 and the resulting collapse of its auditor, Arthur Andersen, in 2002, Cadbury Nigeria Plc in 2006, have called into question the integrity of audit profession.

1.1 Statement of problem

There have been series of enormous corporate failures, such as Enron, WorldCom, Hollinger, Nortel, Cadbury Nigeria Plc, Intercontinental Bank Plc in Nigeria, etc. involving fraudulent audited financial statements. Moreover, Accountancy profession has been the subject of litigation by third parties seeking to recoup their losses. The recognized professional accounting bodies in Nigeria, like ICAN and ANAN, are trying very hard to ensure best practice in the auditing profession via the enforcement of professional code of conduct for their members. Despite the measures taken by the professional accounting bodies in Nigeria, audit failure continues to make headline in our daily newspapers. The audit report users continue to ask "why are auditors negligent over their duties?"

The specific objectives of this study are:

1. To determine whether audit tenure influences auditors' negligence.
2. To determine whether non-audit services provided by auditors lead to auditors' negligence.
3. To ascertain whether interaction of audit tenure and non-audit service lead to auditors' negligence

The study is guided by the following hypotheses:

Ho 1: There is no significant relationship between audit tenure and auditors negligence.

Ho 2: There is no significant relationship between performance of non – audit services and auditors' negligence.

Ho 3: There is no significant interaction between audit tenure, audit fees and the performance of non – audit services to affect the level of auditors' negligence.

1.2 Justification for the study

The outcome of the study will lead to the formulation of a policy that strengthens the profession position on the length of auditor and client relationship that may abet auditors' negligence. Moreover, it will make auditing firm put their own professional code of practice above their clients' organizational culture which prioritized high profits.

1.3 Review of related literature

Audit failure occurs when there is a serious distortion of the financial statements that is not reflected in the audit report, and the auditor has made a serious error in the conduct of the audit (Arens et al, 2002). Whisenant et al.(2003) notes that auditors' negligence is the most important factor blamed for the audit failure that leads to corporate crises. Webster's New College Dictionary (2005) said, negligence is to exhibit a lack of due care or concern, or to fail to care for or give proper attention. Therefore, auditors have to exercise due care when carrying on their duties. Palmrose, (1988) said If the auditor fails to meet the standard of care required and consequently a loss is suffered by any of the affected parties due

to auditor negligence, remedy can be obtained against the auditor in a constituted court of law. For instance, Cadbury Nigeria Plc had been caught in a scandal on October 2006. Akintola Williams, Deloitte was ordered to pay a fine of ₦20 million within 21 days of the decision for its failure to handle the accounts of the company with high level of professional diligence.

According to Johnson et al (2002), as the auditor-client relationship lengthens, there is the tendency that auditors may develop a “learned confidence” in the client which may result in the auditor not performing religiously, the required testing of financial reports. Arrunada and Paz-Ares (1997) argue that a long auditor–client relationship may result to the development of personal relationship that may lead to the bonds of loyalty, trust or emotive relationships been developed between the client and the auditor. In contrary, Caramanis and Spathis (2006) found that audit firm tenure does not have significant effect on auditor’s opinion.

Most of the audit firms provide consultancy services to their client. The consultancy services is used in lieu of non – audit service by auditors. Non-audit services may be any services other than audit provided to an audit client by an incumbent auditor. However, critics contend that providing non-audit service increases auditors’ financial reliance on the client and hence may weaken auditor independence (Wines 1994; Brierley and Gwilliam.2003; Francis.2006; Firth 1997).

In Nigeria, CAMA (2004) Section 358(2a) disqualifies a person or firms who or which offers to the company professional advice in a consultancy capacity in respect of secretarial, tax action or financial management from acting as auditor of that same company. Anichebe (2010) observes that in Nigeria, auditors accept all services (except those for which the auditor has no expertise) as long as there are engagement letters. Therefore, the main question that arises when auditors provide or could provide both audit and non – audit service is whether the auditors are able to conduct their audits impartially, without being concerned about losing or failing to gain additional services, and without considering the subsequent economic implications for the audit firm (Lee 1993).

2. METHODOLOGY

Survey design was used to address the problem of the study. The participants are the Business Analysts, investors’ and Academia. Audit firms were excluded from the study to avoid conformity bias, which may results when members of a profession are included as participants in the study. Audit tenure was measured by number of years that audit firm spent in performing audit assignment with its client. 0 - 3years and 6 years are regarded as short audit firm tenure. While, 9 years, 12 years are regarded as semi – long audit firm tenure.15 years and 18 years and above are regarded as long audit firm tenure. The non – audit services was measured by consultancy services render to its client by auditors such as; human resources function, design of accounting information system, filling of tax return with tax authority, investment advice and valuation services.

2.1 Data Collection

Questionnaire was the instrument used for data collection. The structured questionnaire was administered by hand to the respondents. A four point Likert scale was employed to extract the data. The respondents were made to indicate in the questionnaire the extent they agree or disagree to the stated problems.

2.2. Procedure for Data Analysis

The statistical model chosen for the analysis of data is linear regression analysis and analysis of variance [ANOVA], with the aid of SPSS 20.0 software. The model in its functional form was specified as follows:

$$\text{AudNeg} = f(\text{T1}, \text{Nj},)$$

The first null hypothesis is;

there is no significant relationship between audit tenure and auditors negligence.

The number of years an auditor serves its client was adopted in measuring audit tenure. Test items were developed to obtain audit negligence behaviour score.

The model to be used to confirm this proposition is presented below:

$$\text{AudNeg}_i = B_0 + B_1T_1 + e_i \quad \text{-----} \quad \text{eqi}$$

$$B_i > 0; R^2_t > 0.$$

The B_i is a measure of the impact of audit tenure on audit negligence.

The second null hypothesis is;

There is no significance relationship between performance of non – audit services and auditors’ negligence.

The volume of non – audit services is measure by a battery of test items addressing a number of accounting services which are not audit in nature to obtain audit negligence behaviour score.

The model to be used to confirm this proposition is presented below:

$$\text{AudNeg}_j = B_0 + B_1N_j + e_j \quad \text{-----} \quad \text{eqii}$$

$$B_i > 0; R^2_N > 0$$

B_i measure the impact of non – audit services on audit negligence.

The third null hypothesis is;

There is no significance interaction between audit tenure and the performance of non – audit services to affect the level of auditors’ negligence.

The interaction of audit tenure and non – audit service impact on audit negligence is measure by adding the audit negligence score generated from audit tenure with audit negligence score generated from non – audit services and divide by 3; to derive average negligence score of audit tenure and non – audit services.

The model to be used to confirm this proposition is presented below:

$$\text{AudNeg}_{ij} = B_0 + B_1T_1 + B_2N_j + B_3T_1N_j + e_{ij} \quad \text{-----} \quad \text{-eqiv}$$

$$B_1 = B_2 = B_3 > 0$$

B_1 measure the significant interaction of audit tenure and non –audit services on auditors negligence.

Where:

AudNeg = Auditors Negligence

T1 = Audit firm tenure

Nj = Non – audit services

e = Error term

B_0 B_3 = Coefficient

2.3. Data Presentation and Analysis

The researcher administered one hundred and sixty – two copies of questionnaires randomly to business analysts, academia and investors out of which one hundred and fifteen copies were successfully

retrieved representing 71% of the number of questionnaire administered. The test concerning the parameter was carried out using Analysis of Variance and correlation coefficient.

Table 1 ADMINISTRATION OF QUESTIONNAIRE

DETAILS	NUMBER OF COPIES	PERCENTAGE (%)
COPIES ADMINISTERED	162	100 %
COPIES RETURNED	115	71 %
WRONGLY FILED / UNRETURNED COPIES	47	29 %

Source: field survey 2015

Table 2. Categories of the respondents

Sl. No	respondents	total
1	Business Analysts	7
2	Investors	0
3	Academia	8
	total	15

Source: field survey 2015.

Testing of Hypotheses

Hypothesis One.

Ho: There is no significant relationship between audit tenure and auditors negligence.

Table 3.1a Regression coefficient for Auditors Negligence on Auditors Tenure

	beta	t-test
constant	2.13	t=2.47, p=.069
tenure	0.97	t=6.57, p=.003

Note, $r^2 = .92$, $F(1,4)=43.14$, $p = .003$

Table 3.1b ANOVA RESULT: Audit negligence on Audit tenure.

Model	Sum of square	df	Mean square	F
Regression	69268.63	1	69268.63	43.14
Residual	422.71	4	105.68	
Total	73691.33	5		

a: dependent variable; audneg

b: predictor(constant), audten

Audit tenure explains 92 per cent of variation experienced in auditors negligence, and this result is significant $F(1, 4) = 43.1$, $P < 0.05$.

Auditors tenure makes a positive impact on audit negligence and this is significant, $t(6.57)$, $P < 0.05$.

Therefore, as auditors' tenure increases, auditors' negligence increases.

Decision

Based on the analysis above, the null hypothesis (H0) is rejected while alternative hypothesis (H1) is accepted; which state that there is significant relationship between audit tenure and audit negligence.

Hypothesis Two

Ho: There is no significance relationship between performance of non – audit services and auditors’ negligence.

Table 3.2a Model Summary: Regression coefficient for Auditors Negligence on Non – Audit Services.

		eta	=test
constant	33.5		=15.22, p=.0005
non-audit services	23.5	5	=-1.15, p=.313

Note, r^2 .25, F (1, 4) =1.33, p= .313

Table.3.2b ANOVA RESULT: Audit negligence on non audit service.

Model	Sum of square	f	Mean square	
Regression	736.33		36.33	33
Residual	214.5		53.63	
Total	950.83			

a: dependent variable; audneg

b: predictor(constant), nas

Non audit services explain 25 per cent of the variation experienced in audit negligence, but this is not significant, F (1, 4) = 1.33, p >0.05.

Non audit services negatively affect audit negligence but it is not significant, t(-1.15), P >0.05.

Decision

Based on the analysis above, the alternative hypothesis (Hi) is rejected while null hypothesis (H0) is accepted; which state that there is no significant relationship between performances of non – audit services and auditors’ negligence.

Hypothesis Three

Ho: There is no significant interaction between audit tenure and the performance of non – audit services to affect the level of auditors’ negligence.

Table 3.3a Regression coefficient for Auditors Negligence on Non – Audit Services and audit tenure.

		eta	=test
audit tenure	2.09	68	=7.86, p=.004
non-audit services	8.0	133	=-1.08, p=.361
constant	56.8		=8.96, p=.003

Note, r^2 .95, F(2,3)=31.44, p= .010

Table 3.3b ANOVA RESULT: Auditors Negligence on Non – Audit Services and audit tenure.

Model	Sum of square	f	Mean square	
Regression	23455.3		1727.65	1.44
Residual	110.086		73.03	

a: dependent variable; audneg

b: predictor(constant), nas, audten

Audit tenure and Non audit services explain 95 per cent of the variation experienced in audit negligence, but this is significant, F(2,3) = 31.4, p <0.05.

Again, only audit tenure explain significantly audit negligence, $t(7.86, p < 0.05)$ but non – audit service fail to explain audit negligence $t=(-1.08), p > 0.05$.

Interactions

To test whether audit tenure and non – audit services has any synergetic effect on audit negligence, an interaction term was formed in the regression equation. Table 4.3.3c present the table below

Table 3.3c Regression result of interaction effect

		eta	t-test
audit tenure	2.09	.68	$=7.86, p=.004$
interaction	8.0	.133	$=-1.08, p=.361$
constant	56.8		$=8.96, p=.003$

Note, $r^2 .95, F(2,3)=31.44, p= .010$

A step wise regression was conducted on audit tenure and non – audit service as explanatory variables for auditor negligence. Non – audit service was not significant and was excluded in the interaction process. Only audit tenure was significant. However, when interaction was included in the model, interaction makes a negative impact but was not significant; $t(-1.08), p > 0.05$.

Decision

Based on the analysis above, the alternative hypothesis (Hi) is rejected while null hypothesis (H0) is accepted; which state that there is no significance interaction between audit tenure and the performance of non – audit services to affect the level of auditors’ negligence.

3. SUMMARY OF FINDINGS

Based on analyzed data, the findings in this study include the followings:

1. It was discovered that the relationship between the auditor tenure and audit negligence to be negative and concluded that the shorter the auditor’s tenure, the more they behave in a dependent fashion. This is because familiarity with the client has the effect of reducing the fresh point of view auditors have in the early years of engagement.
2. It was discovered that audit tenure explains 92 percent of variation experienced in auditors’ negligence, and this result is significant. While non – audit services explain 25 percent of the variation experienced in audit negligence, and this is not significant.
3. It was discovered that, as the auditor – client relationship lengthens and auditor is providing some non –audit services to its client, the fees derived from audit service and non – audit services encourages strong economic bond between auditor and its client. This leads to audit negligence.

4. Conclusion and Recommendation

The study found the relationship between the auditor tenure and audit negligence to be positive and concluded that the shorter the auditor’s tenure, the more they behave in a dependent fashion. As auditor tenure increases, auditors’ negligence increases. The length of auditor and client relationship abet auditors’ negligence, then the auditing profession should make significant regulatory pronouncements in this regards. The performance of non-audit service induce auditors’ negligence, then the audit profession is advised to come up with a policy in this regards. Consequently, there is a need to strengthen the capacity of the regulatory bodies and review adequacy of statutory enforcement provisions.

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