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IMPACT OF MANDATORY ROTATION OF AUDIT FIRMS AND AUDIT QUALITY IN CORPORATE ORGANISATION

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ABSTRACT

This study is theoretical in nature and used secondary source of information such as journals, textbooks, conference papers, seminar papers et cetera, to investigate the effects of mandatory rotation of audit firm and audit quality in corporate organizations. The study's conclusions showed that an audit firm's length of time working with a specific client has an impact on the quality of the audit, due to familiarity threat, auditor independence, auditor compliance, conflict of interest, etc. Although many researchers have argued against this policy and its ideas, it became necessary to develop this good idea that would further best protect the interests of the various stakeholders due to the unwholesome attitude and negligence of the auditors and the management of an organization. The study's findings revealed that, in order to boost trust in the system, investors want greater responsibility, transparency, and security for their money both from the audit firms and company management. The study recommended that mandatory rotation of audit firm should be made necessary for corporate organizations, as it is essential for any organization's development and success.

Key words: *Audit, Firm, Management, Organisation, Rotation, Tenure.*

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1. INTRODUCTION

Due to series of prevalent cases of corporate scandals that have occurred in the recent past, it has left many wondering if there has been any measures or controls that have been put in place to checkmate and discourage against the excesses and fraudulent practices by management of an organisation. Recent corporate failures and the inconsistencies in accounting have prompted concerns about the independence, tenure, and quality of audits by auditors (Bricker, 2002). Because investors view a long tenure as having a negative impact on the auditor's independence and audit quality, it is believed that the auditor's closeness to or familiarity with the client as a result of the audit tenure has been the cause of the auditor's lack of independence and objectivity, which makes financial statements less reliable (Ghosh & Moon 2005, Asein, 2007). Audit failure is a widespread issue that transcends national borders.. The accounting profession was nearly brought to shame by cases of Enron, WorldCom, Parmalat, Cadbury, Oceanic bank, Intercontinental bank, African Petroleum Plc (2009), Afribank Plc (2009), and other similar fraudulent situations. Global behemoths as Barring Brothers, Nomura Securities, John Mathews Bank (JMB), Bank of Credit and Commerce International (BCCI), Brex, and Long Term Capital Management (LTCM) all fell in the early 1980s and 1990s due to fraud-related issues (Muraina, Okpara, & Ahunanya, 2010). Following these scandals, a perceived "expectation gap" in the audit quality has been identified since many users of certified financial statements have different expectations of the audit function than what it actually delivers (Beattie, Brandt, and Fearnley, 1999).There have been calls for major reforms to the auditing profession in order to ensure higher audit quality (Auditing Profession, 2002).

Many concerns about audit tenure and quality had been brought up by critiques. Researchers have focused lot on the attention of the subject if an auditor's tenure with a client has an impact on audit quality. To increase auditor independence and lower the chance of audit failure, it has been proposed to rotate audit firms on a regular basis (Walker & Catanach Jr,1999). In ensuring the safety and protection of investors funds for optimal usage is the responsibility of the management team of any organization. Dopuch., King, and Schwartz (2001) conducted an experimental study in the United States and observe the interactions over time between managers who invest in risky assets and an auditor who reports on these assets. They recommended rotating the external auditor to prevent auditor bias resulting from familiarity, could obscure errors in financial reports. They also said that mandatory rotation will lessen the likelihood of auditors developing bias. An auditor's main duty is to review and validate financial statements, books of accounts, and other documents to determine whether the claims made by an organization's directors align with the set standards. Several researchers and scholars suggested stricter measures and control, which brought about the concept of mandatory auditor rotation. At a time when the accounting profession was on the verge of becoming mocked by the society due to the auditor's negligence in handling numerous fraud cases, efforts were made to restore investor confidence and salvage the profession's reputation. However, the American Institute of Certified Public Accountants (AICPA), Ernst & Young, and PwC are among the stakeholders and professional groups that have opposed the concept of rotation. The audit firm rotation may cause auditors who have established a long-standing relationship with a client to lose their auditing expertise, according to the American Institute of Certified Public Accountants (AICPA) (1992). The Sarbene Oxley legislation of 2002 was passed into law in the United States, to prevent the recurrence of these problems in the future. Section 203 of the legislation evaluated auditor tenure, reducing it from seven to five years in order to improve accountability and transparency.

This study urges pertinent authorities to implement sound policies and procedures in order to improve the caliber of financial reports and audit work. Academicians (Geiger & Raghunandan, 2002), practitioners (AICPA's Cohen Commission, 1978), and regulatory agencies (GAO 2003) have all debated the idea of requiring auditors to rotate. By severing long-standing ties between auditors and their clients, rotation rules are believed to lessen barriers to auditor independence. Consequently, they have been set up in nations like South Korea, Singapore, Brazil, India, and Italy (GAO, 2003). Major organizational collapses over the years have been linked to subpar audits and a perceived lack of auditor independence. It was determined that these purported "audit failures" happened as a result of the auditors' inability to find or disclose major mistakes in the financial statements. ' 'If an auditing firm has been auditing the same company for a long time roughly 10, 20, or 30 years and has developed close personal and professional ties with it, how can it continue to be independent? was one of US Congressman Shelby's usual remarks. Due to the financial crisis and the failure of multiple industries, accounting regulators are now more obligated than ever to carefully examine the reporting procedures and accounting regulations that have put strain on the reporting process.

The necessity for high-quality external audit has drawn attention from all around the world in the aftermath of corporate scandals involving Enron, World Com, Global Crossing, Cendant, Sunbeam, Independent Insurance, Equitable Life, Lever Brothers, African Petroleum, and Cadbury. Savanna Bank, Assurance Banks of Nigeria, Allstates Trust Bank, City Express Bank, Hallmark Bank, Metropolitan Bank, Liberty Bank, Eagle Bank, Republic Bank, Premier Bank, Intercontinental Bank, Cooperate Commercial Bank, Gulf Bank, Highland Bank, Lead Bank, Pan African Bank, Progress Bank, Trade Bank, and United Commercial Bank are a few of the banks that have failed in Nigeria. Failures of multinational banks and corporations have raised fundamental concerns regarding the independence of external auditors and the caliber of audits, among other issues. It is becoming more difficult to attract high-quality and long-lasting foreign investments to Nigeria due to the subpar audit reports from banks and businesses. Financial report users are extremely disappointed at the global wave of audit failures, particularly in Nigeria. According to Abdel and Khalk (2000), the board of directors should elect and designate auditors in order to maintain corporate organizations' sanity. Odia (2015) reached conflicting conclusions regarding the rotation of audit firms, although he did note that the new auditor's lack of experience will lead to low-quality audits. Majority of the companies that failed had their auditors appointed by the board of directors, and these auditors had been with the companies for years. According to John and Elijah Oladeji (2018), there is a significant relationship between mandatory auditor rotation and audit quality. The other explanatory variables (Auditor type and Auditor Independence) were taken into consideration alongside audit quality, and it was discovered that the auditors' familiarity with these companies had actually been a threat to their downfall in the past, so the length of time an auditor spent with a client needed to be limited. The aforementioned findings provide evidence of a knowledge gap which this study aims to fill and advance the field of knowledge.

To the best of my knowledge, very few studies have looked at this topic recently, and just a few countries have experimented with requiring audit firms to rotate. There are other problems that need to be addressed, including failed companies, inadequate financial reporting, and auditors who are not fulfilling their duties and responsibilities. This study will be very helpful to businesses, accounting associations, auditors, industry regulators, investors, and so on. The study examines the corporate structure as a whole, financial reports, current national laws and policies pertaining to the rotation of auditors, the profession of auditors, professional associations, industry regulators, and how the rotation of audit firms can help preserve the needs and goals of investors from the past.

1.1 Objective

The objective of this study is to investigate the impact of mandatory rotation of audit firm audit quality in Nigeria.

2. LITERATURE REVIEW

2.1 Conceptual Review

2.1.1 Conceptual Review of Mandatory Rotation of Audit Firm and Audit quality

The Nigerian audit setting, the audit tenure issue, and audit quality reporting have not received much empirical research beyond anecdotal views (Mgbame, Eragbhe, & Osazuwa 2012). Auditors' tenure is a contentious issue at the moment. Should companies regularly switch out their auditors, or should the auditor be given the chance to build a long-term relationship with the client? Users of these reports believe that the creation of high-quality audit reports promotes trust in financial reporting. Particularly investors tend to have more faith in financial statements that have undergone an audit. Within the auditing profession, one of the most crucial issues is audit quality (Akhalumeh, Agweda & Ogunkua, 2017). According to Kiabel (2016), the purpose of auditing is to confirm accounting information in order to evaluate the accuracy and dependability of accounting statements and reports. In order to form a judgment about the truth and fairness of the financial statement claims made during the accounting period, a third party, the auditor, will objectively and methodically analyze an organization's financial records.

This process is known as an audit. The Nigerian Code Corporate Governance (2018) states that an external auditor is appointed to provide an objective opinion on the true and fair perspective of the company's financial accounts in order to reassure stakeholders on the correctness of the financial statements. Auditing involves following procedures to determine if the accounting estimates that management has presented are appropriate. The inability of auditors to find serious misstatements in the financial statement that cast doubt on the statement's credibility is one of the biggest risks facing investors (Iliemena & Okoye, 2019). Chukwunedu, Okafor, and Ofoegbu (2013) contended that apparent inadequacies and perceived deficiencies in the independence of auditors were brought to light by the failure of previous organizations. Corporate failures that have been reported globally over the past several years have prompted serious concerns about the validity and dependability of auditor reports in the event that shareholders' interests are not safeguarded (Egbunike, Egbunike & Okafor, 2017).

High-profile businesses that have failed, like Enron, Cadbury PLC, WorldCom, Africa Petroleum, and a few other deposit money institutions in Nigeria, have demonstrated the negative effects of subpar auditing (Hauwa, Ocheni & Muktar, 2017). For example, Akintola Willian and Deloitte were charged in Nigeria during the Cadbury corporate fraud investigation process for subpar auditing and their role in manipulating the financial statement. In an effort to discover a long-term cure for this act, numerous academics, writers, and researchers have proposed a number of actions. One measure that has been proposed to help reduce the likelihood of fraud and minimize the threat of familiarity is the mandatory rotation of external auditors; this would set a maximum tenure limit for auditors with a firm and preserve their independence (Healey & Kim, 2003; Francis, 2004). Because the new auditor seeks to assess the work done by the departing auditor, the audit firm rotation is a successful peer review technique. Before hiring a new auditor, this can motivate the departing auditor to conduct a better audit. It has been argued that requiring rotation improves audit quality in the year before the rotation as well as the year the new partner is hired (Seidman 2001; Biggs 2002 & Public Oversight Board, 2002).

It was argued that mandatory rotation will improve audit quality in the year prior to rotation as well as the year the new partner is hired (Seidman 2001; Biggs 2002 & Public Oversight Board, 2002). The quality of financial statements is a crucial need for enhancing stakeholders' perceptions of their legitimacy. According to Florence and Kral (2002), audits lower investor risk by offering an impartial confirmation of the financial reports that management has supplied. This increases the confidence of the financial data. China has made it mandatory for enterprises to rotate their audit firms every five years. This rotation needs to be completed by the end of the second year following the initial public offering for recently listed businesses. A comparable legislation was passed by the European Union in 2016, and the UK was supposed to follow suit in 2020. Although the Central Bank of Nigeria's most recent policy to banks recommends that auditors' tenure be limited to 10 years in a circular issued in 2010, there is no upper limit on the number of years an auditor can serve in Nigeria. However, for other corporate organizations in the country, there is a cap on the number of years an auditor can be engaged, typically one year in Company. After serving as Cabulry Nigeria plc's external auditor for 41 years, Akintola Williams Delliotte legally retired. Following this, U.K. Barclays Bank continued to use the same auditor for years after its creation . For more than 85 years, General Motors' external auditor was Delliotte and Touché, while KPMG served as General Electric Company's auditor for a century.

There isn't currently a global regulation defining the duration of an audit firm; but, in Nigeria, the National Code of Corporate Governance is now being reviewed, and one recommendation is for external auditors assigned to supervise company accounts to be required to rotate every five years (The Nation newspaper, 2015). This study backs up the notion that limiting the tenure of auditors will increase the calibre of financial reports and audit work. The idea behind the auditor rotation process is that the departing auditor might want to leave a lasting impression for anyone who might wish to review their work, and the entering auditor would want to offer a new viewpoint and professional skepticism to the workplace.

2.1.2 Concept of Audit Quality

The generally agreed market potential that a specific auditor would uncover and reveal a breach in the client's accounting system is what DeAngelo (1981) describes as audit quality. The ability of the auditor to identify and report financial statement errors is the essence of audit quality (Ndubuisi, Okeke & Chinyere, 2017). Ajekwe and Ibiamke (2017) assert that high-quality audits can boost a company's worth quickly, thus banks must implement effective and efficient resource management. For a financial reporting system to be effective and efficient, audit quality is essential. According to Miettinen (2011), internal financial report users like management, shareholders, audit committees, and the board of directors are interested in audit quality because they think it lowers capital costs and increases market value. External auditing strengthens investor trust in the calibre of financial reports and increases public trust in corporate reporting. The objective of external auditing is to give a reasonable assurance regarding whether the financial statements as a whole are free from material misstatement, whether as a result of fraud or error, so that the auditors can express an opinion on whether the financial statements were prepared in all material respects in accordance with an applicable financial reporting framework and report and communicate the auditor's findings in accordance with generally accepted accounting practice and standards. Vanstraelen and Schelleman (2017) state that an audit is deemed high quality if it conforms with the audit firm's audit execution guide and the applicable auditing standards. According to Detzen and Gold (2021), in order to conceptualize audit quality, it is vital to incorporate various perspectives from various stakeholders with varying interests in financial statements. According to Rajgopal et.al, (2021), the lack of substantial misstatements is regarded by the primary users of financial statements as a sign of audit quality. According to Skinner and Snnivasan (2012), a key factor in raising market value is audit quality. The quality of the audit ensures that the data in the financial statement is reliable.

2.1.3 Arguments for Mandatory Rotation

This familiarity will probably limit the auditor's ability to provide value-added services. For instance, when the auditor starts to predict the state of the client's system, the audit program may become stale (Hoyle, 1978). Church and Zhuang (2006) created a theoretical model to demonstrate the benefits of obligatory rotation, stating that a lengthy rotation phase would result in high startup costs and biased reports. According to Mautz and Sharaf et al. (1961), a longer audit tenure may erode auditor independence and lower audit quality because it may increase familiarity between the auditor and the client. According to Catanach and Walker (1999), the audit business would try to set itself apart from other firms by producing higher-quality work, which would raise the quality of services the auditor supplied. The majority of the justifications for requiring auditor rotation center on the hope that the rule will raise audit quality (Petty & Cuganesan, 1996). European commission in 2010, released a Green Paper with the ideas that proposed changes for a new regulation to audit firm, from the paper it was revealed since longer assignments and the risk of developing close relationships were seen as unwanted threats to auditors, it can affect auditors independence and also affect the quality of the financial report.

Rotating audit firms is defended primarily on the grounds that it will limit the growth of audit-client relationships, which can occasionally compromise independence. One may become less meticulous and more inclined to prioritize the demands of the client as a result of this connection (Martani et al., 2021). According to Kendall et al., (2012), restricting an auditor's long-term contact with a client increases professional scepticism and discourages relying too much on the client's claims. Rotating auditors will improve objectivity, due care, rigor, professional skepticism, thoroughness, and due diligence while lowering management influence and internal pressure. It is assumed that auditor rotation will encourage high-quality audit work and financial reports and allow auditors to freely express their independent opinions. By rotating auditors, the business community will be able to benefit from new perspectives and a decrease in employee complacency.

2.1.4 Arguments against Mandatory Rotation

The proposal's opponents argue that the audit firm would not have had much opportunity to fully understand its client if it had been changed after five years. Additionally, the audit firm's years of expertise have given it a thorough grasp of the business, which puts it in a better position to offer the customer informed advice. Additionally, it has been asserted that audit companies that must rotate could be expensive. According to Morrill (2008), when an auditor is replaced, audit-firm rotation does not improve audit quality. Because audits initially involve one-time start-up costs, necessitating rotations would raise the audit function's cost, claim Gray and Manson (2008). When an audit firm rotates, auditors who have built a long-term relationship with their clients may lose their auditing expertise, which can affect the quality of work produced for a new auditor who might not have perfect knowledge of the client's business, according to the American Institute of Certified Public Accountants (AICPA) (1992). The length of an audit tenure has occasionally been argued to be closely correlated with the client's degree of familiarity with the business environment (Martani et al., 2021).

The association between audit tenure duration and audit quality for businesses listed on the Ammon Stock Exchange (ASE) was examined by Abedalgader, Ibrahim, and Baker (2010). The results show that the audit quality was not significantly impacted. After looking at the relationship between audit firm characteristics and audit quality in Nigeria, Ohiokha Friday

Izien and Ilaboya Ofuan James concluded that there is a negative correlation between auditor rotation and audit quality. Analogously, Adeniyi and Mieseigha (2013) investigated the relationship between audit rotation and audit quality; their results indicate that the two variables are negatively correlated. There is also the argument that the auditor would not be motivated to take the time to fully understand the audit client's complexity because they already know that they will be replaced after a set period of time. Given the complexity and scale of the majority of contemporary firms, Hoyle (1978) contends that the auditor should spend more time with the client to familiarize themselves with the system, record keeping, and internal controls of the business. It is widely acknowledged that the best way to acquire this kind of information is through years and years of real audit experience. Therefore, requiring auditor rotation will reduce the amount of time the auditor spends learning about the organization under audit (Zawawi, 2007). Given the complexity and scale of the majority of contemporary firms, Hoyle (1978) contends that the auditor should spend more time with the client to familiarize themselves with the system, record keeping, and internal controls of the business. It is widely acknowledged that the best way to acquire this kind of information is through years and years of real audit experience. Therefore, requiring auditor rotation will reduce the amount of time the auditor spends learning about the organization under audit (Zawawi, 2007). One could argue that the auditor's views and values may be the reason for the variations in audit quality across the two regimes. This perspective guided the investigation of the effects of obligatory audit rotation and audit quality in Nigeria.

2.2 Theoretical Framework

2.2.1 Inspired Confidence Theory

Limperg Inspired confidence theory (1932) emphasized on the need for management to be accountable and transparent in all their dealings and reports. The stakeholders demands accountability for their contribution to an investment. What can actually inspired the confidence of stakeholders is management accountability and transparency, these are the characteristics expected of the auditors and the management of an organisation, to provide reasonable assurance that the financial statement of an organisation is free from material misstatement and that it represent true and fair view of financial status of the organisation.

2.2.2 Lending Credibility Theory

Lending credibility theory is derived it basis from public perception that the primary function of auditing is to add credibility to the financial statement, the theory emphasized that audited financial statement can enhance shareholders trust in management stewardship. Shareholders usually have less information about the economic activities of a firm, and so they need financial report for accountability and transparency, auditors are suppose to provide coverage to ensure that investors funds are safe by verifying and examining the financial statement if it present true and fair view of the financial status of the firm. With the audited financial statement shareholders are able evaluate the economic performance of the organisation and make appropriate decisions. Audited financial statement provide credibility and reliability on the financial statement, thus the financial statement has been well verified and examined and provide reasonable assurance that the statement is free from misstatement, errors, with this the investors have full assurance to a greater extent that their investment are safe.

CONCLUSION AND RECOMMENDATION

There have been argument for and against the rotation of audit firm in an organisation, what matters most is, if the objective of most policies drawn is been able to achieve the concept of accountability and transparency then it is viable. From the study conducted it revealed that management of an organisation were able to perpetuate fraud cases due to familiarity and lack of independence of the auditor, all these was as a result of a long standing relationship of the auditor with the management of the organisations. This study concludes that it was necessary to adopt the rotation policy in order to enhance integrity, objectivity, independence of the auditor and better audit quality. The study recommend that adopting mandatory rotation of audit firm will bring quality financial reporting, better quality audit work above all inspire the confidence of the investors.

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