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DETERMINANTS OF AUDITOR SWITCHING DECISION IN SELECTED QUOTED NIGERIAN COMPANIES

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Abstract

This study examined the effect of certain factors on auditor switching decisions of selected manufacturing companies in the Industrial goods sector in Nigeria. Specifically, the study sought to ascertain the effects of ownership concentration, audit fees and timeliness of audit report on auditor switching in sampled companies. The ex-post facto research design was adopted for the study. Data were sourced from annual reports of sampled companies for 2015 to 2020 financial years and analysed with binary logistic regression. Results revealed that none of the dependent variables was a significant predictor of auditor switching decisions (p>.05; Nagelkerke R Square= .16). The study concluded that there are auditor switching decisions that are taken without significant consideration of the characteristics examined. It was recommended that independence and professionalism of auditors should be the paramount condition required for the continuous engagement of auditors.

Keywords: Auditor Switch, Audit fees, Ownership Concentration, Timeliness

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1.0 Introduction

A company's shareholders who are also owners usually seek to monitor the actions of management towards wealth optimization and other performances through financial statements. Management on the other hand, makes decisions at different levels to ensure the reports mirror exceptional performances. The pressure to report exceptional performances and get rewards might make management window-dress or falsify reports. To curtail this, the business world developed a means of getting an independent person to carry out a true and fair examination of financial reports prepared by management and issue an opinion as to the state of affairs of the company. This procedure is referred to as Audit. It is usually conducted by an auditor who is a third party is responsible for providing assurance about the fairness of the financial statements presented by the company management. In Nigeria, the Companies and Allied Matters Act (CAMA) mandates every company to appoint auditors. Section 357(1) of the Laws of the Federation (LFN) of Nigeria Cap C20 Companies and Allied Matters' Act (2004) states that: "Every company shall at each annual general meeting appoint an auditor or auditors to audit the financial statements of the company and to hold office from the conclusion of that, until the conclusion of the next, annual general meeting".

Year after year, auditors, which are usually accounting firms, are appointed for this quintessential assignment. The auditor for the previous year might be re-appointed or a different one freshly appointed. When a new auditor is appointed, it is referred to as auditor switch. Putra and Wilopo (2017) defined auditor switching as a change of auditor or public accounting firm conducted by a company that may occur because of government rules (mandatory) or because of the wishes of the company itself (voluntary). From the foregoing, auditor switching could be mandatory or voluntary. Mandatory auditor switching is defined as the auditor switching due to a regulation (Juliardi, Nuris & Zahroh, 2017). Voluntary switching arises either when the company dismisses the auditor or because the auditor submits a resignation letter. In relation to this study, auditor switching refers just to one of the types- the voluntary switching.

Voluntary auditor switching occurs as a result of client-related factors such as ownership change, and auditor-related factors such as audit fees (Khasanah & Namury, 2013). Amdany (2012) stated that the major reason for change of auditor was found to be the demand by the shareholders during annual general meetings especially those that have high proportion of the total shareholding. Moreso, Eniola and Ajayi (2018) stated that the Audit fee charged by the auditor is an important consideration in selecting an auditor. High fees might cause certain companies to change or engage another auditor. Furthermore, an audit firm that delays issuance of its audit report could make client firms decide to switch to a faster auditor.

This study thus seeks to empirically verify how much certain factors influence auditor switching in selected companies in the consumer goods sector.

1.1 Statement of Problem

Firms with a single shareholder holding a substantial proportion of shares than others are likely to have binding decisions on overall company decisions because of the power and voting rights they possess. These shareholders are also likely to be more concerned about monitoring as they have higher stake in investment. As a result, possibilities exist that they could influence auditor switching if they feel certain things are being threatened. A shareholder with less than 5% stake may not have such power to influence such. However, the researcher found no work examining the effect of this situation- ownership concentration on auditor switching decisions.

There is mixed evidence from existing literature on the relationships between different factors and auditor switching. These studies have also been conducted in environments different from Nigeria and hence the results may not be generalized for Nigerian firms (Kusrina & Yulivani 2017; Mohammad & Habib, 2013). Related works for Nigerian firms have centred on audit delay, auditor choice and audit quality (Olowookere, 2016; Eniola & Ajayi, 2018).

For these reasons, this study seeks to extend and contribute to the existing empirical literature in order to contribute in resolving the inconsistency in findings using sampled public listed firms from the Consumer goods sector.

1.2 Objectives of the Study

The broad objective of this study is to determine the factors that determine auditor switch in selected quoted companies. To ensure a more directional path of study, specific objectives were coined out from the broad objective. They are: to determine:

1. how ownership concentration affects auditor switching
2. the effect of audit firm fees on auditor switching
3. the effect of timeliness of audit report on auditor switching

1.3 Research Hypotheses

The following null hypotheses were formulated for inferential analyses:

1. Ownership concentration does not have a significant effect on auditor switching.
2. Auditor switching is not significantly affected by audit firm fees.
3. Timeliness of audit report does not have a significant effect on auditor switching.

2.0 Literature Review

2.1 Conceptual Review

2.1.1 Auditor Switching

Auditor switching involves change of incumbent auditor resulting in the choice of quality differentiated audit firms to realign the characteristics of the audit firm, with the growing need of clients under changing circumstances (Juliardi et al, 2017). Auditor switching could be mandatory or voluntary (Khasharmeh, 2015). Mandatory switching requires the auditor to be changed after a number of years despite the objectivity, independence, efficiency and quality of the auditor, the willingness of the shareholders and the management to keep the auditor (Onwuchekwa, Erah & Izedonmi, 2012).Voluntary switching is dismissing an incumbent auditor and appointing a new one for reasons not related to legal bindings.

Auditor switching is a very important decision in a firm though it may seem not to be. The importance lies in auditor independence and signals to investors. Auditor switching may have impact on auditor independence and may diminish the credibility of audited financial statements (Khasharmeh, 2015). The auditor's independence is viewed as one of the important principles of the auditor's job. It is argued that if the auditor cannot preserve the independence principle, the value of audited financial statement decreases and this resulted in uncertainty in investment activities in capital markets.

There are several factors that may cause auditor switching, such as the termination of the employment contract without any extension of new assignments and the conflicts of interest between the owners and the management of the company resulting in a change of

management and a change of auditors. An important issue raised by Jackson, Moldrich and Roebuck (2008) is that firms can switch audit firms because managers dislike or disagree with the qualified reports from the audit firm. A switch could be used to avoid a qualified report if a new auditor is less likely to give a qualified report. This suggests that firms in financial distress have more incentives to change auditors than healthy clients. Furthermore, first year audits costs relatively twice much time as normal. If all public interest entities are forced to switch audit firms, it will create loads of extra work while the resources or available accountants are limited.

Amdany (2012) stated the following as some of the determining factors for auditor-switch: expertise; management change; change of auditor at the head office; demand by the shareholders; affordable fees; satisfactory quality of audit; shareholders demand; auditor's good reputation; accessibility of auditor, timeliness of audit report; lack of reporting disputes; demand by the head office; and unsurpassed industry expertise.

For this study, factors to be examined are restricted to three factors which are ownership concentration, audit fees and timeliness of audit report).

2.1.2 Ownership Concentration: This is the pattern of share ownership of a company's shareholders. A company could have shareholders that have more than 5%, 25% or even more than 50% as in a subsidiary showing block ownership or every shareholder not holding up to 5% of total shares showing a highly diffused ownership pattern. Blockholders tend to have more influence in the selection of auditors than a company that is very diffused in relation to shareholding. When a major shareholder requires a change in auditor, the company is more likely to switch to satisfy the investor. For ownership concentration, the study employs the highest substantial interest in shares as proxy.

2.1.3 Audit Fees

Maharani, Wahyudi and Azwardi (2018) defined this as the amount of the cost of the assignment risk, the services complexity provided, the expertise level required to perform the service, the cost structure of public accountant and other professional considerations. Audit fee refers directly to payments made to the auditor that relates directly to the audit function. Generally, the audit fee should cover audit costs and provide a reasonable profit. Therefore, the audit fee can be seen as a combination of two kerns; audit cost and profit or auditors' reward (Urhoghide & Emeni, 2014). When the audit fee exceeds the affordability of the company, the company will seek other qualified auditors with lower audit fee causing voluntary switching (Maharani et al, 2018). Amdany (2012) also stated that fees precipitate change more often when they exceed "acceptable tolerance limits". Otherwise companies find that it is not worth going through a costly auditor change process as a reaction to a slight fee increase.

2.1.4. Timeliness

Apadore and Noor (2013) opined that the timeliness of submitting financial reports can increase the usefulness of the information produced. The longer the period taken for submission of financial statements, the lower the economic value of these financial statements. An audit engagement requires the auditor to complete his fieldwork punctually. In addition, companies that are late in publishing their audited financial statements will be subject to fines in accordance with the applicable laws and regulations. This indicates that timely delivery of financial statements is necessary (Putra & Wilopo, 2017). The study uses the interval (number of days) between the end of the accounting period and the date of issuance of the audit report. This is adopted from Putra and Wilopo (2017).

2.2 Theoretical Framework

The study is anchored on the agency theory because the basis of audit is the existence of the principal-agent relationship that exists between shareholders and management.

2.2.1 Agency Theory

This was propounded by Jensen and Meckling in 1976. They defined the agency relationship as a contract under which one or more persons (the principal(s)) engages another person (the agent) to perform some service on their behalf, which involves delegating some decision-making authority to the agent. The agency theory arises when management and ownership of a company are separated (Graaf, 2011). The agency problem exists because managers (agents) have different goals and motives compared to the shareholder (principal) (Graaf, 2011). Shareholders on one hand, are focused on creating profit and value for the company, to maximize the return on their investment while managers on the other hand, are more interested in creating value and wealth for themselves. Olowookere (2016) stated that the most important basis of Agency Theory is that the managers are usually motivated by their own personal gains and work to exploit their own personal interests rather than considering shareholders' interests and maximising shareholder value. Managers will always try to maximize their utility, but this utility does not have to be the same as the utility wanted by the shareholders. In most cases, the agent will not always act in the best interests of the principal. The agents could also hide information for selfish purpose by non-disclosure of important facts about the organization (Barako, Hancock, & Izan, 2006). This difference of interest widens the information asymmetry between the principal and the agent. As a result, the principal lacks trust in agents and requires independent parties as mechanism of supervision (Juliardi et al, 2017). To reduce this information asymmetry or agency costs as the case may be, owners appoint independent auditors to ascertain the truth and fairness of information reported by management. Independent audit reduces agency costs by verifying the truthfulness and competence of the financial statements, thereby allowing more precise and efficient contracts to be based on the financial statement (Khasharmeh, 2015).

Decision to change auditors by client firm was due to the principle-agent problem in separation of ownership and control of a firm (Jensen & Meckling, 1976). This decision was birthed from the need to maintain independence of the third party (auditors) to reduce information asymmetry and maintain investors' confidence in the credibility of financial reports.

2.3 Empirical Review

Mohammad and Habib (2013) investigated the effective factors on mandatory auditor changing by selecting a sample which consists of 200 companies that are accepted in Egypt stock market. By applying multi-variable regression model to primary data from survey, their research showed that there is a negative significant relationship among auditor's industry profession and reputation and changing auditor. They also found a positive relationship among auditing report delay, auditor opinion, auditing salary and changing auditor.

Ferdiano, Restuningdiah and Achadiyah (2015) aimed to test the effect of the company size, customer's company size, management switching, financial distress, and audit fees on voluntary auditor switching. Logistic regression results showed that the management switching has significant positive effect on voluntary auditor switching. It was concluded that if the company has main director switching, the company tends to do voluntary auditor

switching. Meanwhile, the Public Accounting Firm size, the customer company size, financial distress, and audit fees had no proof of affecting voluntary auditor switching.

Olowookere (2016) investigated the determinants factors affecting auditors' choice in quoted manufacturing companies in Nigeria. The study utilized both primary data and secondary data. Logistic Regression Analysis was used to analyze the data. The results showed that the two most important factors influencing the company's choice of auditors are international coverage and long-term relationship with current auditors.

Eniola and Ajayi (2018) sought to identify the effect of audit fee, complexity, board size, board independence and audit firm choice on auditor choice in 35 manufacturing companies. Secondary data was used for the study. The binary regression technique was used in estimating the models. The results revealed that corporate governance mechanism and firm complexity have significant effect on the likelihood that a firm chooses a type of auditor.

Maharani et al (2018) conducted a study to determine whether audit fees, percentage change in audit opinion, change in management and financial distress influence voluntary auditor switching in real estate companies. Secondary data from annual reports of sampled companies were analysed with logistic regression and interaction test. Results showed that the percentage change in audit opinion, change in management did not affect auditor switching while financial distress and audit fees had significant influence.

Kusrina and Yulivani (2017) aimed to determine certain factors that affect the auditor switching, i.e. management turnover, the size of firm, financial distress, the size of company, audit fee, and ROA. Using logistic regression analysis, results showed that only management turnover significantly influences auditor switching.

Wiyantoro and Usman (2018) examined the effect of audit tenure, audit quality, and Non-Audit Service on audit report lag (ARL) in banking companies in Indonesia. Multiple linear regression results indicated that audit tenure, audit quality and Non-Audit Service have negative and significant impact on audit report lag.

3.0 Methodology

The study adopted the *ex-post facto* research design. In this study, secondary data from annual reports of past periods were subjected to inferential analyses to achieve study objectives. The study got data for 2015 to 2020 financial years from selected companies in the industrial goods sector.

S/N	Variable	Proxy	Reference
1	Auditor Switch	Dummy variable 1 and 0. 1 indicates auditor switching from one public accounting firm to another public accounting firm. 0 indicates no auditor switching	Winata & Anisykurlillah, (2018)
2	Ownership Concentration	Measured as the ratio of shares owned by the largest shareholder to the total number of shares outstanding.	
3	Audit fees	Audit fee expense	Maharani et al (2018)
4	Timeliness	Interval (number of days) between the end of the accounting period and the date of issuance of the audit report	Putra and Wilopo (2017)

Data collated were analysed with the Logistic regression analytic tool using the Econometric Views, Version 9 statistical software because this form of regression adjusts regression surface to data when the dependent variable is dichotomous.

Hence the logistic regression in our model is explained by the model below adopted from Juliardi et al (2017) but however modified to suit this study:

$AUDSW_{ij} = \beta_0 + \beta_1 \, ln OWNCON_{ij} + \beta_2 ln AFEES_{ij} + \beta_3 TIME_{ij} + \varepsilon_{ij}$

where: AUDSW= *l*Auditor Switching; OWNCON= ownership concentration; AFEES= Audit fees; TIME= Timeliness of audit report; β_0= constant; $\beta_1 - \beta_3$= coefficient of independent variables; ε = error term

Decision rule for hypotheses: Accept null hypothesis if beta coefficient for independent variable is negative. However, reject null hypothesis and accept alternate hypothesis if coefficient is positive.

4.0 Results

Table 1: Model Summary

Step	-2 Log likelihood	Cox & Snell R Square	Nagelkerke R Square
1	26.430[a]	.103	.160

a. Estimation terminated at iteration number 5 because parameter estimates changed by less than .001.

The Cox & Snell R Square and Nagelkerke R Square values are also referred to as pseudo *R-Squared* values but used in the same manner. The study model thus has a predictive power of 16%. Nagelkerke R^2 is a modification of Cox & Snell R (Adjusted R squared).

Table 2: Classification Table[a]

	Observed		Predicted: Auditor Switch: No Switch	Predicted: Auditor Switch: Switch	Predicted: Percentage Correct
Step 1	Auditor Switch	No Switch	22	1	95.7
		Switch	6	0	.0
	Overall Percentage				75.9

a. The cut value is .500

'.500' in Table 2 is the probability of 0.5 showing binary data was employed for the dependent variable, auditor switch. The positive predictive value is 75.9% explaining the percentage of actual correctly predicted auditor switch occurrence compared to the total number of cases predicted as having switch.

Table 3: Variables in the Equation

		B	S.E.	Wald	df	Sig.	Exp(B)	95% C.I.for EXP(B)	
								Lower	Upper
Step 1[a]	Audit fees	.000	.000	1.558	1	.212	1.000	1.000	1.000
	Timeliness	.013	.010	1.505	1	.220	1.013	.992	1.033
	Ownership Concentration	-.016	.024	.445	1	.505	.984	.939	1.031
	Constant	-2.528	1.457	3.011	1	.083	.080		

a. Variable(s) entered on step 1: Audit fees, Timeliness, Ownership Concentration.

The Wald test statistic depicts statistical significance the independent variables affirmed by the sig values. Results on the table above, table 3 show that timeliness (p = .003); ownership concentration (p = .021) and audit fees (p = .039) did not add significantly to the model.

4.1 Discussion of Findings

Binary regression results showed that auditor switching decisions occur independently of fees charged by auditors and time in which audit engagement takes. Firms do not particularly switch auditors on the basis of their fees. This can be ascribed to the sensitivity of audit exercises especially for publicly quoted companies. A new auditor might also have more tough time grasping the operations of the firm and its internal reporting patterns which makes organisations overlook fees implications. Companies may not be taken to switch auditors for fees because audit fees are also tax-deductible. Ferdiano et al (2015) also found that audit fees are inconsequential to auditor choice or switching. This however is contrary to the findings of Mohammad and Habib (2013) as well as Maharani et al (2018) that found that audit fees are capable of causing auditor switching decisions.

The timeliness of audit engagement is largely dependent on the client firm's size, operations and state of reporting and accounting and thus does not propel auditor switch decisions. Mohammad and Habib (2013) have opposing results. They found that audit delay positively relates with auditor switching decisions.

On the part of the firm, ownership structure was not found to significantly influence auditor switching decisions. Block owners may be more interested in profitability and other investment- aligned performance indices than they will with the engagement of auditors. They are likely to be concerned with auditor switching when it is required by law such as the 10-year maximum tenure for auditors specified to promote auditors' independence.

5.0 Conclusion

Auditor switching is a certain decision made by firms whether voluntarily or statutorily. However, firms switch auditors earlier than the 10-year maximum tenure for different reasons. The study sought to determine the influence of auditors' characteristics- audit fees and timeliness of audit engagement and firm's characteristics- ownership concentration on auditor switching decisions. The study concludes that audit fees, ownership concentration and timeliness of audit engagement are not significant predictors of auditor switching decisions of quoted manufacturing firms in the Industrial goods sector.

5.1 Recommendations

In line with study findings, the following recommendations were made:

1. The independence of auditors should be the paramount condition required for the continuous engagement of auditors.
2. Professionalism rather than fees should be prioritized for audit engagement.
3. Despite the insignificance in timeliness found, it is important for audit engagement to be rounded off within stipulated time for timely report filing at the specified authorities such as the Securities and Exchange Commission, the Federal Inland Revenue Service and the Corporate Affairs Commission.

5.2 Contribution to Knowledge

This paper contributes to existing literature by providing empirical evidence of the predictive measure of audit fees, timeliness of audit engagement and ownership concentration on auditor switching decisions in selected quoted industrial goods firms.

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