

Effect of Audit Fees on Audit Quality: Evidence from Cement Manufacturing Companies in Nigeria.

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ABSTRACT: *This paper aims to examine the effect of audit fees on audit quality in Nigeria using a sample of listed cement companies on the floor of the Nigerian Stock Exchange. In specific terms, the study investigates the relationship between audit fee, audit tenure, client size, leverage ratio and audit quality. Ordinary Least Square Model estimation technique was employed to analyze the relationship between the explanatory variables and the dependent variable. Secondary data derived from the published annual reports of the selected companies for a six year period (2010-2015) was used for the study. Findings from the study show that audit fee, audit tenure, client size and leverage ratio exhibit a joint significant relationship with audit quality given coefficient of determination (R^2) being 0.6006 and a combined p-value of 0.001 and $F_{calc}=7.14$. This implies that the predictive power of the independent variables as used to explain changes in audit quality is about 60%. Audit fee in particular shows a significant positive impact on audit quality with a t and p-values of (4.04 and 0.001) respectively as well as a high positive correlation coefficient of 0.7513 with audit quality. The study recommends that Government through the various professional bodies should develop robust policies that will help improve audit quality in Nigeria.*

KEYWORDS: *Audit Quality, Audit fee, Audit tenure, Client Size, Leverage Ratio* .

INTRODUCTION

The issue of agency which emanated from the separation of ownership and control of firms gave birth to the need for external audit services. While the daily activities of the firms are within the control axis of the managers, who may or may not have any shareholdings of significant value in the firm, the ownership of the firms lies in the hands of the investors who are the shareholders. This implies that there is a residual claim on the resources of the firm by the shareholders and the managers are obliged to give the stewardship of the resources to the shareholders; usually through financial statements on periodic bases. (Securities and Exchange Commission, 2000).

In order to ensure the reliability of the financial statement made available to the public, it is usually required that the statements are certified by an appointed auditor who serves as an objective and

rigorous third party that confers credibility to the financial statements from the users' perspective through an independent examinations of the statements. The main aim of audit assignment as advocated by some auditing scholars is to generate a report with good and acceptable quality.

Furthermore, in recent times, research about the quality of audit report has increased tremendously, several factors were found to have contributed to this fact, stemming from the growing importance of good corporate governance mechanism following the highly publicized accounting scandals in Nigeria and across the globe. The collapse of many big corporations, such as world Com and Enron in the United states as well as Cadbury Nigerian plc and Lever Brothers plc in Nigeria have been associated with poor audit quality traced to a perceived lack of independence of auditor. The adoption of questionable accounting practices by some companies in Nigeria in recent times have led to the independence of auditors being questioned, thereby subjecting the credibility of auditing profession into doubt (Otusanya and Lauwo, 2010). In other to ensure that the report of auditors have the needed level of assurance to the investors whose fund are in the companies, auditors have being subjected to pressure as a result of questionable accounting practices.

Moreover, the global financial crisis has put many companies under severe pressure to embark on cost reduction. This has invariably affected the audit fees, probably with the intention to share the pain traceable to the cost. However, the proportion of audit fee to the total cost is usually small and cost reductions do not have significant impact on a company's bottom line. In the current economic conditions external auditors continue to be faced with more difficult judgments in areas such as assessing going concern, impairments of assets and fair values. This invariably leads to increase in time spent on an audit and the increased time is expected to increase rather than reduce audit fees.

While it is possible for auditors to maintain audit quality with a marginal reduction in fee, the audit committee of companies should ensure that they inform the Board of any risks associated with reductions in audit fees. The old sayings 'pay peanuts and you get monkeys' can apply. Studies that focus on factors influencing audit quality abound in literatures both within and outside the shore of Africa and audit fee among others was found to be a factor influencing audit quality but with divergent view as to the direction and extent of effect it has on audit quality. For instance, Fitriany et al (2016) studied the impact of Abnormal Audit Fee on Audit Quality in Indonesia, a negative association was found to exist between abnormal audit fee and audit quality. According to them, the mandatory audit firm rotation and existence of high competition within the Indonesia audit market could prompt discount in audit fee to further improve audit quality.

Furthermore, Srinivasan et al (2002), theoretical models have explained that the issues of audit fee and audit quality do generate conflict of interest between auditor and their clients, but this should not in any case make audit fee to have diminishing effect on auditor independence, thus the offer of the amount of the fee has to be offered by clients. Audit fees are the fees provided to the auditors that reflect the cost of the effort conducted by the public auditors and risks of litigation (Choi, 2009). With respect to the factors informing the decision of the appropriate amount of audit fees, Simunic (1996) argued that audit risks, client size, and audit complexity determine audit fees. In fact, audit quality will be impaired when auditors are overpaid. When the amount received by auditor from a client is unusually high, the auditor will tolerate the client to engage in opportunistic

earnings management because the associated costs such as increased litigation risk, loss of reputation can be outweighed by the benefits to the auditor. This is further supported by Choi et al (2010) who stated that abnormal audit fees can be viewed as “client-specific quasi-rents”. Moreso, an incentive for the auditor to compromise independence with respect to a specific client can be created through the existence of (positive) client-specific quasi-rents (De Angelo 1981; De Fond et al. 2002; Chung and Kallapur 2003). Suffice it to stress that audit fee abnormality could mean too low below standard fee or too high above standard fee. Blankley et al. (2012) found that audit fee that is lower than normal (discount) may reduce audit quality. The lower audit fees may be traced to the client’s strong bargaining power in the process of bidding (Barnes 2004). If the fee is lower than normal, audit firm will adjust their audit efforts, reduce their audit procedures such as reducing the number of hours of audit, use less experienced staff, etc (Gregory and Collier 1996; Eshleman and Guo 2013).

Statement of the Problem

Empirical research on audit quality abounds in literatures both within and outside Nigeria. To mention but a few, Listya and Sukrisno (2014) examined Influence of auditor independence, audit tenure, and audit fee on audit quality of members of capital market accountant forum in Indonesia, Belén (2015) studied the link between auditor tenure and audit quality in Spanish state-owned foundations, Determinants of External Audit Fees with Evidence from the Banking Sector in Nigeria was investigated by Soyemi *et al* (2013), Enofe *et al* (2013) examined Audit Quality and Auditors Independence in Nigeria, Babatolu (2016) *et al* with a focus on Nigeria Bank also relate auditor’s independence and audit quality. While many factors such as audit fee, Audit firm reputation, audit tenure, were found to exhibit some level of relationship with audit quality in different sectors including banking and manufacturing sector at large, not too much study of this nature has been carried out with respect to the Cement manufacturing sub-sector of the Nigeria economy. According to Mojekwu et al (2013), both locally manufactured cement and imported cement contributed positively to the Nigeria Gross Domestic Product. Arising from this, this study attempts to bridge the gap by investigating among others, the effect of audit fee on audit quality of cement firms in Nigeria. The study therefore seeks answers to the following research questions; what is the relationship between audit fee and audit quality? Does auditor’s tenure have any effect on audit quality and to what extent does client size affect audit quality in the cement sector of Nigeria? On the basis of this, this study therefore intends to achieve the following objectives:

Objectives of the Study

The general objective of the study is to examine the effect of audit fee on audit quality. The specific objectives are as follow:

- i. T
o investigate the relationship between audit fee and audit quality of quoted cement companies in Nigeria.
- ii. T
o examine the linkage between Auditor’s tenure and audit quality of quoted cement companies in Nigeria.
- iii. T
o determine the relationship between client size and audit quality of quoted cement companies in Nigeria.

Hypotheses

The following hypotheses are formulated to be tested;

H0₁: There is no significant relationship between audit fee and audit quality of quoted cement companies in Nigeria.

H0₂: Auditor's tenure does not have any significant influence on audit quality of quoted cement companies in Nigeria.

H0₃: There is no significant relationship between client size and audit quality of quoted cement companies in Nigeria.

REVIEW OF RELATED LITERATURES

Concept of Audit Quality

According to the consultative council of accountancy body (CCAB) Audit is defined as an independent examination of and expression of opinion on the financial statement of an enterprise by an appointed auditor, in pursuance of that appointment and in compliance with any relevant statutory obligation. To this end, audit is expected to improve the value of information presented in the financial statements and as a result of this, audit quality has to do with a display of professionalism, diligence and care by auditor in audit process which should lead to a true and fair view of financial statement (Arrunada, 2000).

Although audit quality does not have a universally accepted definition, different scholars in their studies explain the term audit quality. To mention but a few, Arens *et. al* (2011) defines the quality of the audit to mean how well an audit detects and report material misstatements in financial statements, the detection aspects are a reflection of auditor competence, while reporting is a reflection of ethics or auditor integrity, particularly independence". Davidson and Neu (1993) define audit quality as the ability of auditors to discover and reveal light material misstatements and manipulations in net income reported. This is corroborated by findings from Salehi and Azary (2008) who stressed that the capability of an auditor in the protection of the interest of users of financial statement through the detection and reporting of material misstatements and diminution of information asymmetry between the users of financial statement and management explains audit quality. They further opined that the existence of audit quality is validated when a financial statement is free from information asymmetry. According to Palmrose (1988), in defining audit quality, actual quality and perceived quality have been contended as essential issues. While actual quality is regarded as the likelihood of reducing the associated risk of reporting a material misstatement in financial statement, perceived quality has to do with what the users of financial statement believe about the ability of auditor to reduce material misstatement.

Moreover, there are certain fundamental characteristics to watch out for when audit quality is a subject of discussion. This according to Yuniarti (2011) include Reliability (which has to do with how dependable are the auditor's findings and to what extent do the findings reflect a true and fair view of audited entity's financial statement), Significance (what value is tied to the audit?), Scope (which has to do with whether the entire aspects of the audit is properly addressed), Objectivity (what level of independence was exhibited in the audit process?), Clarity (was the audit outcome well communicated and recommendations made?), Timeliness (was the duration of the audit work

too long, too short or just normal before the audit report was submitted?), Effectiveness (does the audit actually achieved its objective?) and Efficiency (was the cost of the audit outweighed by the associated benefit?). According to him, the integration of these characteristics as a whole gives quality to the audit. This implies that audit quality is prominent where these characteristics can be identified.

Audit fee

Audit fee can be explained to be the amount charged by the auditor for an audit assignment carried out. That is, the amount charged by the auditor for any work done in order to express opinion on the true and fair state of affairs or position of the client's enterprise. Iskak (1999 in Suharli and Nurlaelah, 2008) described audit fee as the fee charged by a public accountant to the client for the financial audit services. This is in accordance with the opinion of The Securities and Exchange Commission, Final Rule (in Yuniarti, 2011) that the audit fee is the fees paid for annual audits and reviews of financial statements for the most recent fiscal year. The amount of audit fee can vary depending on the complexity of services, assignment risk, the cost structure of Public Accountants Firm, the required level of expertise, and other professional considerations.

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

Audit Tenure

Audit tenure is the agreed period of engagement between the auditor and client (Hartadi, 2009). The issue of audit tenure is usually linked to auditor independence. Research conducted by Ghosh and Moon (2003) shows that audit quality increases as audit tenure increases. This result is however contrary to the results of a research conducted by Indah (2010) which reveals that as the length of auditor-client relationship increases; there could be decrease in the level of audit quality, because too long auditor-client relationship impairs auditor's independence. Furthermore, the audit quality decreases as the auditor-client relationship lengthen (Deis and Giroux, 1992). Corroborating this finding, Carey and Simnett (2006) also find that, in Australia, long audit partner tenure is associated with lower propensity to issue a going-concern report. However, the study involving going-concern report in the US suggest that audit reporting failures are significantly higher in the first few years of auditor-client relationship (Geiger and Raghunandan, 2002). According to Chen et al., (2008), audit firm tenure as well as audit partner tenure, affects financial reporting quality.

EMPIRICAL REVIEW

Following the previous financial reporting scandals in big corporations such as WorldCom, Enron and other companies, audit quality has gained increased concerns and attention. Various researchers have as result of this tried to identify possible factors that influence audit quality as reflected in the financial reports of companies in various industries. This subsection of the study

reviews some of the works of researchers in this area of study. According to Ghosh and Pawlewicz (2008), positive relationship between audit fees and audit quality is caused by several things among which are auditing time and the skill of the staff. They stated that the more the auditing time, the higher the audit fee. Moreover, audit fees will be high if the auditing procedures involve highly skilled and experienced audit staff. This implies that high quality audit is associated with higher audit fees.

Furthermore, According to Yuniarti (2011), the complexity of services provided, expertise, risk of assignment, and other professional considerations determine audit fee charged by auditor. The study further reveals that higher audit fee enhances a higher quality audit. However, a contrary opinion is observed in Supriyono (1988 in Wati and Subroto, 2003); which shows that a high amount of audit fee can impair the independence of public accountants, this he attributed to the fact that the big fee can inhibit reluctance of audit firms to controvert the will of the client, while small fee has the tendency to limit the cost and time to carry out complete audit procedures.

Using multivariate regression technique with emphasis on Logit and Probit method, Ilaboya and Ohiocha (2014) empirically examined the impact of audit firms' characteristics on audit quality. The study revealed that a negative relationship exists between auditor's independence, audit firm size, audit tenure and audit quality. Examining the relationship between audit partner tenure and audit quality, Chijoke, *et al* (2012) found that there is existence of negative but insignificant relationship between auditor tenure and audit quality. On the contrary, by applying the dispersion of accruals as a proxy for audit quality, Myers *et al*, (2003) report that as tenure of auditor lengthens, the discretionary accruals and current accruals are less dispersed, thereby suggesting higher earnings quality. Apart from accruals, Stanley and DeZoort (2007) used restatement as a surrogate for low quality of financial reports. Their findings also suggest that as the auditor-client relationship lengthens, there is corresponding decreased in the likelihood of restatement, implying better financial reporting quality. Findings from Knechel and Vanstraelen (2007) reveals neutral effect of auditors tenure on audit quality as they find that longer auditor tenure neither reduce nor increase possibility of auditor's issuance of going concern report for a company that went bankrupt thereafter.

METHODOLOGY

Both historical and descriptive research design was adopted by this paper. As a result of the fact that the paper simultaneously combines cross sectional and times series data, a panel data analysis was carried out. The population of this study comprised all the cement manufacturing companies in Nigeria which include BUA cement, UNICEM, Eastern Bulk Cement, Purecome, IBECOM, Dangote Cement, Lafarge Africa, Ashaka cement and Cement Company of Northern Nigeria. Purposive sampling technique was used to select sample size of four (4) companies, namely, Dangote Cement, Lafarge Africa, Ashaka cement and Cement Company of Northern Nigeria. These companies are chosen being the only quoted cement manufacturing companies in Nigeria. Secondary Data covering a period of six (6) years (2010-2015) was used for this study and the data were sourced from the audited annual report of the sample companies. Multiple regressions using ordinary least square method of estimation (OLS) and correlation was adopted as the Data analysis techniques for the study.

Model specification and measurement of variables

$$\text{AUDQUAL} = \alpha + \beta_1 \text{AUDFEE} + \beta_2 \text{AUDTEN} + \beta_3 \text{CLTSIZE} + \beta_4 \text{LEV} + \mu \dots (i)$$

Where:

AUDQUAL= Audit Quality

AUDFEE=Audit fee

AUDTEN= Auditor's Tenure

CLTSIZE= Client Size

LEV =Leverage

Measurement of Variables**Table 1: Descriptions of Variables**

S/N	Variables	Definition	Type	Measure
1	AUDQUL	Audit Quality	Dependent	1 if audit firm is BIOG4 and 0 if otherwise.
2	AUDFEE	Audit Fee	Independent	Natural log of Audit fee paid by the client firm.
3	AUDTEN	Auditor's Tenure	Independent	1 if 3 years and above, 0 if less than 3 years.
4	CLTSIZE	Client Size	Control	Natural log of total asset of the client firm
5	LEV	Leverage	Control	Total debt/Equity

RESULT AND DISCUSSION

The empirical analysis of influence of audit fee on audit quality in selected cement manufacturing company in Nigeria within a period of six years [2010-2015] was presented in this section. Data obtained from secondary sources were analyzed in relation to the objective of the study. This part of the study is divided into two; the first part gives the descriptive analysis while the second part gives the inferential statistical analysis of the data followed by discussion of findings.

Descriptive Statistics

Presented in table 4.2.1 below is the descriptive statistics of the variables. The result shows that AUDQUL has a mean value of (0.70833), maximum and minimum value of 1 and 0 respectively. The 1s are for BIG4 and 0s for other firms. The standard deviation of (0.4643) shows there is little deviation from the mean. AUDFEE has a mean value of (10.25), maximum value of (12.16) and minimum value of (8.00). The standard deviation of (1.22) shows a considerable dispersion from the mean. AUDTEN has a maximum value of (1) and a minimum of (0). The standard deviation of (0.4643) shows a little dispersion from the mean value (0.70833). CLTSIZE has a maximum and minimum value of (N107 Billion) and (N963 Billion) respectively with a mean of (N218 Billion). The standard deviation of (N269 Billion) shows a significant deviation from the mean value of (N218Billion). LEV has a mean value of (0.7208005), maximum value of (1.721388) minimum value of (0.2420378) and a standard deviation of (0.4075849) indicating significant deviation from the mean.

Table 4.1 Descriptive Analysis of Variables showing the relationship between audit fees and auditors' quality

Variable	Observation	Mean	Standard Deviation	Minimum	Maximum
Year	24	2012.5	1.744557	2010	2015
AUDQUL	24	0.7083333	0.4643056	0	1
AUDFEE	24	10.25545	1.218383	8.006368	12.16003
AUDTEN	24	0.7083333	0.4643056	0	1
CLTSIZE	24	2.18e + 08	2.69e +08	1.07e +07	9.63e + 08
LEV	24	-0.4731947	0.5542133	-1.418818	0.5429055

Source: Authors' Computation, 2016.

Inferential Statistical Analysis

Regression Analysis of the relationship between audit fees and auditor's quality.

Impact analysis of audit fee was in this section hypothesized as a functional determinant of audit quality. AUDFEE, AUDTEN, CLTSIZE, and LEV were used as proxy for the independent variable (audit fee) while audit quality (AUDQUL) is the dependent variable. Result from the analysis indicated that significant relationship exists between AUDQUL and the independent variables taken together with both coefficient of determination (R^2) and adjusted R^2 being 0.6006 and 0.5165 (60.06 % and 51.65%) respectively and a combined p-value of 0.0011 and $F_{calc}=7.14$. This implies that the predictive power of the independent variables as used to explain changes in AUDQUL is about 60.06%.

Furthermore, while three of the explanatory variables including AUDFEE, AUDTEN and LEV exhibit positive relationship with AUDQUL, only CLTSIZE shows a negative effect. However, only AUDFEE shows a significant impact on AUDQUL with a t and p-values of (4.04 and 0.001) respectively. To this end the study rejects the null hypothesis and accepts the alternative hypothesis that 'there is significant relationship between audit fee and audit quality of quoted cement companies in Nigeria'. With respect to Auditor's tenure and Client Size, the study accepts the null hypotheses that there is no significant relationship between AUDQUL and AUDTEN given a p value of 0.605 and also between AUDQUL and CLTSIZE given a p value of 0.246. Summary of the analysis on the relationship between audit fee and audit quality is presented in table 4.2.1 below.

Table 4.2.1 Results of the Regression Analysis Showing the Relationship between audit fees and Auditor Quality.

Dependent variables	Independent variables	Coefficient	Standard Error	T	p> t	[95% conf. interval]
AUDQUL	AUDFEE	-0.0162973	0.0911617	-4.04	0.001	0.1773187 0.558926
	AUDTEN	0.0800221	0.1520534	0.53	0.605	-0.2382293 0.3982735
	CLTSIZE	-4.81e-10	4.01e-10	-1.20	0.246	-1.32e-09 3.6e-10
	LEV	-0.0327557	0.181069	0.18	0.858	-0.346226 0.4117375
	Constant	-3.042319	0.9141287	-3.33	0.004	-4.955612 -1.129025
R-squared =0.6006 Adj. R-squared = 0.5165 P = 0.0011 F (4,19)= 7.14						

Source: Authors' Computation, 2016.

Correlation Analysis

A pairwise correlation test between AUDQUL and AUDFEE further strengthens the result. AUDFEE was found to exhibit a strong positive correlation with AUDQUL given the coefficient of correlation (r) of 0.7513 between the variables. Moreso, AUDTEN shows a moderate but positive correlation with AUDQUL (r= 0.4794), CLTSIZE exhibit weak positive correlation (r=0.1933) while LEV shows a very weak negative correlation (r= -0.2436) with AUDQUL as shown in table 4.2.2 below.

Table 4.2.2 Result of pairwise correlation between audit fee and audit quality

	AUDQUL	AUDFEE	AUDTEN	CLTSIZE	LEV
AUDQUL	1.0000				
AUDFEE	0.7513	1.0000			
AUDTEN	0.4794	0.7339	1.0000		
CLTSIZE	0.1933	0.3799	-0.0053	1.0000	
LEV	-0.2436	-0.3288	-0.2938	-0.2468	1.0000

Source: Auditor's Computation, 2016.

CONCLUSION

The study empirically examined the relationship between audit quality and audit fee as well as other related factors including audit tenure, client size and Leverage ratio. Using data from the four (4) quoted cement manufacturing company in Nigeria between 2010 and 2015, the results revealed that such a relationship does exist. Audit quality was found to be significantly related to audit fee with a positive relationship. The positive relationship implies that the quality of audit is dependent on the audit fee; the higher the audit fee, the more qualitative and reliable the audit work will be. To this end, this study concludes that audit quality and audit fee is positively and

significantly related. This corroborates findings from Husam, *et al* (2013), Novie (2013) and Babatolu *et al* (2016). Moreover, while audit tenure was found to exhibit positive but insignificant relationship with audit quality, client size and leverage ratio were found to show negative insignificant relationship with audit quality. These findings are consistent with the works of Yuniarti (2011) and Listya *et al* (2014). In order to improve audit quality of manufacturing companies in Nigeria, especially within the cement manufacturing companies, the study recommends that the Government through the various professional bodies should develop robust policies that will help improve audit quality in Nigeria. Moreover, a well-defined standard sanctioned by law should be put in place to regulate audit fee and auditors' tenure in Nigeria. Auditors should as well ensure that the quality of audited financial statement is improved upon in order to boost the confidence of users of financial statement and the general public. Moreover, companies should ensure that the debt- to-equity ratio of the business is kept as low as possible so as not to impair on the quality of audit carried out.

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