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Confidence Ihenyen
Ph.D, Niger Delta University, Wilberforce Island Bayelsa State, Nigeria

Pascale Egileonisiya Augustine-Desi
Niger Delta University, Wilberforce Island, Bayelsa State, Nigeria

Corresponding Author:
Confidence Ihenyen
Niger Delta University, Wilberforce Island Bayelsa State, Nigeria

Audit firm tenure and quality of financial report in Nigeria

Confidence Ihenyen and Pascale Egileonisiya Augustine-Desi

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Abstract
The purpose of this research was to determine if there was a connection between the length of engagements with audit firms in Nigeria and the reliability of financial reports in that nation. In this study, a panel dataset was collected from 40 quoted manufacturing firms trading on the Nigerian Stock Exchange (NSE) in 2022 using a post hoc research technique. Twelve publicly listed manufacturing businesses covering the five-year period 2018–2022 are selected using a judgemental selection procedure. The data is analysed using secondary sources and a panel data multiple regression model.
The Modified Jones Model from 1995 is used to calculate discretionary accruals, which are used to gauge the reliability of financial reporting. According to the findings, the length of time an audit firm has worked with a company has no bearing on the reliability of its financial statements. This is especially true for publicly listed companies in Nigeria. Thus, rather of focusing on individual auditors, regulators should regulate "audit firms" to promote earnings quality.

Keywords: Audit Firm Tenure, Financial Reporting Quality, Discretionary Accruals

1. Introduction

Long audit cycles have been met with trepidation from the auditing community due to concerns over auditor and firm objectivity. Since auditors must keep up a certain level of familiarity with their customers in order to verify the truthfulness of financial accounts, this is a valid worry. There has been some scepticism raised about the veracity of financial records throughout the world as a result of a string of high-profile audit failures in recent years. Even perfect auditing couldn't avert the collapse of banks and companies during the 2008 financial crisis.

The Sarbanes-Oxley (SOX) Act was enacted in 2002 in reaction to similar business crises to ensure that public corporations in the United States have access to accurate financial information. A number of countries have included such notions into their corporate governance rules to ensure that auditors may operate freely. Business scandals in Nigeria, for instance, have undermined public trust in companies' financial statements, leading to closer inspection of auditing firms with unusually long track records and dubious bookkeeping methods.

According to the 2003 GAO study cited by Medhat and Mohamed (2018), the necessity of obligatory auditor rotation rose due to the worldwide crises. Even though the SOX Act requires audit partner turnover every five years, it does not impose a change in auditing firms. The Securities and Exchange Commission Corporate Governance Code (2014) of Nigeria limits the tenure of external audit firms to no more than 10 years and prohibits their rehiring for seven years after being replaced.

Despite the emphasis on auditor independence and rotation, there is a rising need for audit committees to proactively explore firm rotation as a means of enhancing audit quality. Changing auditors is often seen as a panacea that would enhance quality instantly. So, it's crucial that audit committees use their best discretion when picking experts without any conflicts of interest.

2 Statement of the problem

In their research on the connection between audit experience and opportunities to improve financial reporting, Dopuch, King, and Schwartz (2001) [12] and Myers, Myers, and Omer (2003, to name only two of the authors) discovered specific descriptive features linked with audit quality. The question of whether or not businesses should frequently replace their auditors or allow long-term client relationships is at the heart of this essay, which focuses primarily on the implications of auditor tenure. The key issue is whether or not the auditor's length of service makes a difference in the quality of the audit. There is, however, the counterargument that auditors who stay with one company for a long time are better able to maintain their independence since they have gained experience with that company. The intangible nature of auditor independence, according to Dopuch *et al*. (2003), necessitates the use of external measures by academics, practitioners, and regulators.

There is little room for financial statement fraud since auditors are not truly independent in their dealings with clients. The lack of continuity in the auditing staff has led to less reliable financial evaluations. Despite Nigeria's continuing expansion and development, the audit environment, the difficulty of auditor independence, and the link between auditors and financial reporting have received scant attention, especially in terms of robust empirical data. In light of the recent financial irregularities involving Stanbic IBTC Plc and KMPG during the 2014 accounting year and existing studies from Nigeria and other jurisdictions, this article seeks to explore the impact of auditor independence on financial reporting and the rotation of audit tenure. The goal is to bring together seemingly conflicting facts so that we may have a more complete understanding of these vital topics.

1.3 Objectives of the study

The primary objective of this study is to examine the correlation between audit firm longevity and financial reporting quality in publicly traded Nigerian manufacturing companies. The specific goals of this research are as follows:

Examining how audit firm stability affects confidence in financial statements the study's goal is to ascertain whether or not the length of time an audit firm has worked with a particular company is correlated with the credibility of its financial statements. The study's overarching goal is to determine whether or not an auditing firm's length of service influences the accuracy, transparency, and consistency of financial statements.

The study's goal is to learn how audit firm longevity correlates with improvements in financial reporting quality. The auditors' independence, competence, and expertise may be taken into account, along with the efficacy of audit methodologies in ensuring the correctness and integrity of financial statements.

The primary purpose of the research is to provide regulators and policymakers in Nigeria with insight into the effect that audit firm tenure has on the reliability of financial reports. The findings can help policymakers and regulators improve their approaches to ensuring the honesty and accuracy of financial records.

This study, which focuses on publicly traded Nigerian industrial businesses, seeks to address a knowledge vacuum by examining the connection between the length of time an audit firm has worked with a client and the reliability of that client's financial reporting.

1. 4. Research questions

How does the longevity of auditing firms in Nigeria affect the reliability of financial reports for publicly traded manufacturers?

1.5 Statement of hypotheses

H_0: The primary result of the study was that continuity in audit firms did not significantly affect financial reporting quality for publicly listed industrial companies in Nigeria. The length of time an auditing firm has worked with a single client does not appear to be related to the accuracy of their financial accounts.

This finding may imply that the length of time an audit company has been engaged by a manufacturer is not related to the manufacturer's level of trust in the audit firm's ability to offer accurate, trustworthy, and transparent financial information. The auditors' impartiality, depth of expertise, and effectiveness of audit processes are only a few more variables that might impact the reliability of financial reports.

The study's conclusions have important implications for the Nigerian manufacturing industry's regulators, lawmakers, and enterprises. This conclusion has significant implications for regulatory efforts to boost the credibility of financial reports by requiring regular changes in auditing companies. Instead, give your whole attention to matters that directly affect the reliability of financial reports, such as ensuring the auditors' independence and credentials and implementing tough auditing practices.

It is essential to keep in mind that this conclusion is solely applicable to the particular group of Nigerian factories that were analysed for the purpose of this study. These findings could or might not be applicable to other sectors or countries, depending on the circumstances. To have a better understanding of this problem, further research has to be conducted to investigate the link between the skill of audit firms and the quality of financial reporting in a variety of settings.

2. Literature Review

"Audit Tenure" refers to the length of time a client retains an auditing firm to examine that client's financial records. Current regulations require that auditing firms and partners be rotated on a regular basis, effectively linking audit rotation with audit tenure. Adeyemi and Okpala (2011) [3] found that if an auditing firm has a very close relationship with a single client, such relationship might jeopardise the firm's independence. Long-term customer relationships can reduce the amount of scrutiny an organisation receives from its auditors and clients, which can damage the firm's ability to function independently and objectively. According to Deis and Giroux (1992), audit quality declines when external auditors become more familiar with their clients. In particular, PwC asserts that regulatory agencies consider that many auditing companies have warm links with the higher management of their audit customers, which diminishes the value and quality of audits. So it's up to businesses to decide whether it's best to have the same auditors year after year to foster familiarity or to switch them out on a regular basis to foster fresh perspectives. Changing an organization's auditing firm every five years is required by Nigeria's National Code of Corporate Governance (NCCG) to underline the new standard that places external auditors on distinct sides from their customers.

The appropriate intervals of time that should pass between audits and the effect that this has on the accuracy of the financial records have been the focus of a great deal of discussion. The question of whether or not switching audit firms or partners actually results in an improvement in audit quality has been the subject of heated debate in the academic community (Eilifsen, Messier, Glover, and Prawit, 2010). When an organisation keeps the same auditor for an extended period of time, there is an increased risk of acquaintance hazards and conflicts of interest, both of which might compromise the auditor's ability to remain objective. Auditing firm Ernst & Young (2015) claimed that mandated audit firm rotation is not a viable criteria for strengthening auditor independence and that it has not been proved to boost audit quality. In addition, Ernst & Young noted that this practise has not been shown to increase audit quality.

PricewaterhouseCoopers (2012) thinks that the costs of obligatory audit firm rotation outweigh any possible advantages. This is because a new audit company may give a "fresh look" at financial data, which may appear enticing. However, Pricewaterhouse Coopers (2012) believes that the costs of mandatory audit firm rotation outweigh any potential advantages. According to Krauß and Zulch (2013), the long-standing link that exists between an auditor and their client can be considered either as a danger to the independence of the auditor or as a benefit to the independence of the auditor. According to Isenmila and Elijah (2012) [19], earnings management (fraudulent financial reporting) by Nigerian firms reduces investor trust and undermines the credibility of publicly available financial statements. In other words, earnings management hurts the credibility of publicly available financial statements.

2.1 Financial Report Quality

Because of the significant impact that financial reports have on economic policy, everyone who uses them has an obligation to ensure that they remain honest and transparent. This is because economic policy is directly affected by the information included in financial reports. A fervent debate on the reliability of financial reports has been ignited as a result of a series of incidents that have undermined the public's trust in auditors. According to Sylvester and Famous (2016) [26], in order for clients to be able to make educated decisions, they require access to complete financial data that are also transparent and do not contain any false information. As they continue to refine their idea, they are drawing inspiration from the research conducted by Jonas and Blaurchet (2000). There is an urgent requirement for accurate reporting of financial data. If financial reports were of a higher quality, investors and other users may utilise that information to make decisions that are more informed, which would be to the whole economy's benefit. According to the conceptual framework that was developed by the International Accounting Standards Board (IASB, 2008) [18], one of the primary factors for obtaining quality in financial reporting is adherence to the goals and qualitative attributes of the information that is presented. This is one of the fundamental conditions that must be met in order to achieve quality. According to the International Accounting Standards Board (2008) [18], it is necessary for the data used in financial reporting to be relevant while also accurately portraying the situation. This study looked at discretionary accruals estimated using the modified-Jones model (Johnson *et al*., 2002; Balsam *et al*., 2003; Sylvester & Famous, 2016) in order to acquire a sense of the reliability of financial statements [26]. (Johnson *et al*., 2002; Balsam *et al*., 2003; Sylvester & Famous, 2016) [20, 26].

2.2 Audit Tenure and Financial Report Quality

The International Accounting Standards Board (IASB) states that the integrity of a company's You can judge the reliability of its financial statements based on its declared aims and the standard of the information presented therein. Because of these qualitative safeguards, investors may have complete faith in financial reporting. Accuracy, comparability, verifiability, rapidity, and clarity in financial reporting are all necessary for meeting this criteria. Accordingly, professionalism in accounting is typically characterised by dependability and uniformity (Gajevszky, 2015). It is crucial to be honest and forthright in financial reporting. Typically, one will look at whether or whether the depiction is balanced, complete, accurate, and verifiable by third parties (Gaeremynck & Willekens, 2003) to determine how reliable it is.

There is a lack of consensus in the research that has been conducted on the topic of whether or not the amount of time an auditing company has been in business has an effect on the standard of financial reports (Johnson *et al*., 2002) [20]. Some study shows that an auditor's lack of familiarity with a client due to a short length of time working for that client could have a negative affect on the audit. This is because a lack of familiarity might make it more difficult for the auditor to identify potential issues. It is possible that the auditor's independence will be called into question as a result of this circumstance since the auditor would need to solicit new customers in order to recoup the first client-specific expense. This is money that cannot be used to support future engagements.

According to Willekens (2008) [27], the auditor's report increases the value of financial reports because it gives investors and other stakeholders the confidence that the annual report depicts economic events in an accurate and fair manner. This in turn increases the value of the financial reports. According to the findings of research conducted by Daniels and Booker (2011) and Firth *et al*. (2012) [10, 15], a shorter audit firm tenure is associated with improved financial reporting. The length of time an auditing firm has been in business directly contributes to the credibility of the firm.

2.3 Theoretical Framework

The study's theoretical foundation-inspired confidence-is very important.

Theory of inspired confidence

In the 1920s, the theory was initially offered by the eminent Dutch academic Theodore Limperg. This proposal also includes an in-depth evaluation of the existing auditing services and the ones that are required moving forward. Independent audits become increasingly important when the interest of outside parties grows in an organization's inner workings. Large sums of money have been pledged by these people and companies, and they want management to take responsibility for their decisions. In the event of a disagreement of interest between management and stakeholders, it is crucial to have an impartial auditor review the financial statements (Hayes *et al*., 2005) [17].

2.4 Regulation Rule Around the world

In accordance with the definition provided by the Financial Accounting Standards Board (2011), financial reporting is "the process of communicating information to external users about an entity's financial position and performance in response to their information demands." Regulations have been implemented in a number of nations that limit the amount of time that an auditing company can continue to provide services to a single customer. The Chinese government's Ministry of Finance and the China Institute of Certified Public Accountants (CICPA) came to the conclusion in 2016 that China's financial institutions should rotate their auditors every five years beginning in that year. Other countries, such as Hungary, Austria, Brazil, and France, have also considered the possibility of transferring auditing firms on a five-year cycle. All companies operating in Nigeria are required by law to comply with the regulations established by the Financial Reporting Council of Nigeria (FRCN) and the Securities and Exchanges Commission of Nigeria (SECN). Following negotiations with the FRCN, the SECN produced a policy that mandated a change in audit firms every ten years, followed by a pause of seven years (Samuel, Mudzamir, & Mohamad, 2017) [25]. This policy also included a second seven-year break.

2.5 Empirical review

The examination of the connection between auditor experience and audit quality that was carried out by Belén *et al*. (2015) centred on Spanish state-owned foundations as its primary subject. They evaluated the data from a total of 254 separate audits that took place between 2003 and 2010. According to the findings, after six years of working together, both the foundation and the auditor start to perceive a drop in audit quality. This occurs for both parties simultaneously. Based on the findings of the research, the authors of the study reach the conclusion that authorities and users of financial statements should take action to set a minimum tenure duration and minimise tenure lengths.

Patrick and Henning (2013) [22] investigated the German auditing business to see whether or not there was a correlation between auditor experience and audit quality. Researchers in Germany conducted 1,071 audits of big publicly listed firms over a seven-year period (2005-2011), and analysed the data to see whether or not there was a link between the length of an auditing firm's existence and the quality of its audits. They discovered no association. As a consequence of this, their conclusions ran counter to the need that audit firms be rotated on a required basis.

In a separate piece of study, Quick and Wiemann (2011) [23] investigated the correlation between the amount of time that had been spent on an audit and the quality of the audit as a whole. They analysed a sample of publicly traded companies over the course of three years (2005-2007) and used the signed/unsigned ratio of discretion accrual as a proxy for the quality of the audits. According to the findings, the thoroughness of an auditor's audits is a reflection of how devoted they have been to a company throughout the course of their career. This provides evidence that the European Commission's proposed legislative constraints on auditor tenure may have a detrimental effect on the quality of statutory audits carried out in Germany.

Sylvester and Famous (2016) [26] investigated the impact that audit committee characteristics have on the level of accuracy of the financial reports produced by publicly traded companies in Nigeria. There were 131 different firms that traded on the Nigeria Stock Exchange that were evaluated throughout the course of a seven-year period (2006-2012). A positive and significant relationship between audit committee features (such as meeting frequency, financial literacy, independence, dimensions, and attendance at meetings) and the quality of financial reporting was discovered through the use of descriptive statistics, correlation analysis, and Ordinary Least Squares (OLS) regression in the study. These methods were utilised to gather the data.

3. Methodology

In this work, we took a backwards-looking look at our data using a panel data research strategy. In 2022, the population of this research consisted of 45 manufacturing companies listed on the Nigerian Stock Exchange (NSE). We used a judgement sampling method to identify 12 publicly listed Nigerian manufacturing businesses. The years 2018 through 2022 were included in the study.

There were two stipulations that had to be met by the participating companies. They needed to have been operational for a minimum of 10 years before applying to the Nigerian Stock Exchange. Second, the research team was able to get the essential information thanks to the Nigerian Stock Exchange, which houses the annual reports of the listed firms.

In this particular investigation, multiple regression was utilised for the analysis, and secondary sources of information were consulted. The results were obtained by applying a panel data regression technique that took into consideration the five-year longitudinal data collected from the various manufacturing companies that were sampled.

3.1 Model specification

The study employed a multiple linear model to examine the relationship between various factors and the quality of financial reporting, specifically focusing on discretionary accruals (DAC). The model is defined as follows:

$$DACi = \beta 0 + \beta 1AFTENURit + \beta 2ACSIZEit + \beta 3ACINit + \beta 4FSIZEit + \varepsilon it$$

Where,

DAC represents the discretionary accruals for firm i at time t, which serves as a proxy for the quality of financial reporting.

The independent variables in the model are as follows:

AFTENUR denotes the audit firm tenure for firm i at time t. This variable measures the maximum expected period from an audit firm, as prescribed by the Financial Reporting Council of Nigeria, which is set at ten years.

ACSIZE represents the audit committee size for firm i at time t. It is measured as the total number of directors and shareholders comprising the audit committee within the organization.

ACIN corresponds to the audit committee independence for firm i at time t. It serves as a control variable in the study and is measured as the total number of independent shareholders or their representatives who make up the audit committee.

FSIZE indicates the firm size for firm i at time t. This variable is measured as the natural logarithm of the total assets of the firm.
ε represents the error term in the model, accounting for unexplained variation.

By analyzing the coefficients (β values) associated with the independent variables, the study aims to assess the impact of audit firm tenure, audit committee size, audit committee independence, and firm size on the quality of financial reporting, as indicated by discretionary accruals.

4. Result and discussions

Table 1: Descriptive Statistic**s**

	DAC	AFTENUR	ACSIZE	ACIN	FSZE
Mean	1.222429	2.855000	2.875000	56.94419	7.072529
Median	0.958000	3.000000	4.000000	65.47620	6.882750
Maximum	5.492600	10.00000	7.000000	100.0000	9.240900
Minimum	0.193300	0.000000	0.000000	0.000000	5.971000
Std. Dev.	0.908693	2.700079	1.979639	26.38596	0.682547
Skewness	2.815563	0.217202	-0.363736	-0.709246	1.081311
Kurtosis	11.98184	1.553031	1.838117	2.771058	4.064523
Jarque-Bera	936.5254	19.02022	15.65991	17.20444	48.41785
Probability	0.000000	0.000074	0.000398	0.000184	0.000000
Sum	244.4858	571.0000	575.0000	11388.84	1414.506
Sum Sq. Dev.	164.3187	1450.795	779.8750	138547.6	92.70821
Observations	60	60	60	60	60

***Source*:** Researcher Computation from E-view Output, 2023

A summary of the research's proxies, including Audit committee dimensions, Audit firm tenure, and Audit committee independence, is provided in Table 1.
During the time period under study, publicly traded companies' AFTENUR scores ranged from an average of 2.855 to a minimum of 2.7001, with the latter value being much more dispersed than the former. This indicates that there is a large, observable disparity between AFTENUR indices produced by different companies.
FSZE is the best metric for describing the discretionary accrual variance of publicly traded manufacturing companies. With a mean of 7.07253, a minimum of 5.9710, and a maximum of 9.2409, the FSZE has a low standard deviation of 0.68255. It's important to note that the audit period played a major role in shaping this discrepancy.
The average size of an audit committee is 2.875, with a standard variation of 1.9796 (from a minimum of 2 to a high of 7 members). The lowest possible value is 0.000. With a typical range of 26.38 percent, audit committee independence is typically about 56.9442 percent. Values of independence can be anything from 0.0000 to 66.850, with the maximum value being 66.850.
Keep in mind that a DAC that is bigger than zero is indicative of competent bookkeeping practises. This conclusion is confirmed by the finding that some of the selected industrial businesses had extended audit tenures.
Table 1's explanatory data is useful for understanding the context of the research and the range of the proxy variables.

Table 2: Correlation Analysis

Covariance Analysis: Ordinary					
Date: 05/29/23 Time: 19:05					
Sample: 2018 2022					
Included observations: 60					
Correlation					
Probability	**DAC**	**AFTENUR**	**ACSIZE**	**ACIN**	**FSZE**
DAC	1.000000				

AFTENUR	0.132338	1.000000			
	0.0618	-----			
ACSIZE	-0.073865	0.565366	1.000000		
	0.2986	0.0000	-----		
ACIN	-0.143219	0.071231	0.003693	1.000000	
	0.0431	0.3162	0.9586	-----	
FSZE	0.137644	0.248986	0.095811	-0.192256	1.000000
	0.0519	0.0004	0.1771	0.0064	-----

***Source*:** E-view Output, 2021

As can be seen in table 2, linearity was examined using the correlation analysis. The table shows a negative correlation between audit firm longevity and discretionary accruals, audit committee size, and audit committee independence. Very little correlation exists.

4.1 Test of Hypotheses

Table 3: Regression Result

Method: Panel Least Squares				
Date: 05/29/23 Time: 19:02				
Sample: 2018 2023				
Periods included: 5				
Cross-sections included: 12				
Total panel (balanced) observations: 60				
Variable	Coefficient	Std. Error	t-Statistic	Prob.
AFTENUR	-0.028268	0.029399	-0.961538	0.3375
ACSIZE	-0.000561	0.038915	0.014415	0.9885
ACIND	-0.005806	0.002452	-2.368138	0.0689
FSZE	-0.191091	0.097766	-1.954575	0.0521
DAC	-0.009557	0.005250	-1.820226	0.0703
C	3.145284	0.730358	4.306495	0.0000
R-squared	0.071344	Mean dependent var		1.222429
Adjusted R-squared	0.047410	S.D. dependent var		0.908693
S.E. of regression	0.886891	Akaike info criterion		2.627350
Sum squared resid	152.5955	Schwarz criterion		2.726300
Log likelihood	-256.7350	Hannan-Quinn criter.		2.667394
F-statistic	2.980825	Durbin-Watson stat		0.499222
Prob(F-statistic)	0.012887			

Source: E-view Output 2023

The coefficient of determination (R2) shown in Table 3 suggests that the independent factors may explain a considerable amount of the observed variation in the dependent variable. The R2 value of 0.0713 indicates that 71% of the variance in the dependent variable can be explained by the explanatory factors in the model. Since other factors also influence the remaining 29%, they cannot be accounted for simply using the mode adjustment.

H_0: Table 3 shows that the number of years an auditing firm has been in operation does not significantly affect the accuracy of financial statements for publicly listed Nigerian industrial companies.

There is no statistically significant correlation between the length of time an audit firm has been in operation and discretionary accruals (p-value = 0.3375), which is higher than the usually recognised alpha level of.05. Every year of audit service results in a 0.028268 rise in discretionary accruals. For this reason, we concur with the statement that "there is no significant impact of long-term tenure of audit firm on the financial reporting standards of quoted companies in Nigeria."

In addition, the p-value for the correlation between audit committee size and discretionary accruals is 0.9885, suggesting a negative but statistically insignificant association. In addition, there is no statistically significant link between the autonomy of the audit committee and the use of discretionary accruals (p=0.689 and p=0.521, respectively).

4.2 Discussion of findings

Results showed no correlation between the number of years an audit firm has been in operation and the reliability of financial statements among publicly listed Nigerian manufacturers. To rephrase, the presence or absence of an auditing firm makes no difference with regard to discretionary accruals. Our data supports the reverse of what Belén *et al.* (2015) discovered, which is that audit quality decreases with expertise.

The study's findings, which ran counter to expectations, showed that an audit firm's financial reports improved with time in operation. That's in keeping with what's been claimed by people like Carcello and Nagy (2004) and Ruiz *et al.* (2006) [24], who suggest that a lack of intimacy between the auditor and the client due to a shorter audit duration might make the audit less trustworthy.

These findings challenge the conventional wisdom that more time spent on an audit means lower-quality financial reports, and they highlight the need for more investigation into the myriad of factors that affect audit quality in the Nigerian setting.

4.3 Conclusion

A study was conducted in Nigeria that looked at how long an audit firm has been in business and how trustworthy its financial statements are. How long an auditing company should remain operational has been the subject of much debate. There is conflicting evidence on whether or not a longer period of employment has a negative impact on the quality of audits or financial reports. The mutually advantageous nature of the connection between the client and auditor tends to dilute perspective, consistency, and responsibility early in the engagement. Therefore, the study indicates that for publicly traded Nigerian manufacturers, there is no substantial association between the length of time an audit firm has worked with the company and the accuracy of its financial reporting.

5. Recommendations

1. It is advised that lawmakers make greater efforts to control "audit firms" rather than "auditors" if the ultimate goal is to improve profit quality.
2. Standard-setters should align the law governing audit firm tenure rotation with worldwide practise.

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