ACCOUNTANTS’ PERCEPTION ON THE EFFECT OF MANDATORY JOINT AUDIT ON AUDIT QUALITY IN SOUTHWESTERN NIGERIA

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Abstract

This study examined the accountants’ perception on the effect of mandatory joint audit on audit quality in Southwestern Nigeria. The data on the perception of accountants in academics and practice were gathered through the use of structured questionnaire. Analysis were carried out using Mean and Analysis of Variance (ANOVA) methods tested at 5% significance level. The findings revealed that mandatory joint audit would not contribute positively to audit quality. It was therefore recommended that joint audit should not be mandatory. The choice of number of auditor(s) is the responsibility of shareholders and audit committee who may appoint joint auditors if they believe it would add value to the company.

Keywords: Audit fees; Audit Quality; Mandatory joint audit.

A. Introduction

Confidence in the reliability of published financial information is essential to the healthy functioning of markets to the benefit of business, investors, creditors, employees and other stakeholders. The purpose of an audit is to enhance the credibility of financial statements by providing written reasonable assurance from independent sources that the financial statements show a true and fair view in accordance with the accounting standards. However, criticism of the audit profession that resulted from the recent spate of global business and financial scandals have raised many questions about the quality of external audits. The question was now how could these companies collapse just after receiving a clean audit opinion? As the financial statements users do not have access to the audit working papers, it is difficult for them to directly assess the quality of an auditor. The recent scandals have demonstrated that auditor independence is a very important factor for audit quality. Auditor independence can be defined as an auditor’s freedom from those pressures and other factors that compromise or can reasonably be expected to compromise an auditor’s ability to formulate unbiased audit judgements. Auditor independence is the cornerstone of the auditing profession since it is the foundation of the public’s trust in accounting profession (Lindberg & Beck, 2004, cited in Oladipupo & Izedonmi, 2013).

Concerns about the reliability of financial statements are not new. The conventional wisdom holds that joint audits would improve audit quality by enhancing audit evidence precision because “Two heads are better than one”, and by preserving auditor independence, because it is more expensive for a company to “bribe” two audit firms than one (Deng, Lu, Simunic & Ye, 2012). One of the most important mechanisms proposed by the European Commission in 2010 was the practice of Joint audits to improve audit quality through improving auditor competence and independence, and reduce audit market concentration through encouraging the emergence of small audit firms. In fact, the European Commission (EC) has stated that one of the key objectives in the push for joint audit arrangements is to promote greater diversity in an otherwise highly concentrated audit market. Currently, France is the only country in the European Union (EU) that mandates joint audits for companies that publish consolidated financials. As a result, the country’s auditing industry is considerably more diversified and competitive compared to the other nations in the EU.

In Nigeria, Section 357 of the Companies and Allied Matters Act, Cap., C20 LFN 2004 provides that every company shall at each Annual General Meeting (AGM) appoint auditor or auditors to audit the financial statements of the company. The appointed auditors shall hold
office from the conclusion of the AGM in which they were appointed to the conclusion of the next AGM.

The term “Joint audit” is used to describe a situation in which two auditors who are collectively assigned to plan and perform the audit including the interpretation of the results of audit procedures complete the engagement and issue audit opinion. Joint audit can be defined as an audit in which financial statements are audited by two independent auditors with shared audit effort, one single auditors’ report signed by both auditors, and joint liability for both auditors (Ratzinger-Sakel, Audousset-Courtier, Kettunen & Lesage 2012). Joint audit generally involves appointment of a lead audit firm and a support audit firm by a client with the mandate to jointly carry out the audit of a given entity within a defined time period usually a year. Joint audit can potentially enhance the competition in the audit market by allowing smaller audit firms to maintain larger market shares. In a joint audit setting, there are two or more independent auditors jointly liable for the issued audit opinion. The proposal of the European Commission in 2010 to introduce the joint audit created a lot of doubt on whether joint audit could add value to the audit process.

In Nigeria, voluntary joint audit is no longer popular in Deposit Money Banks compared to the early 90s. For example, out of 191 audits conducted on publicly quoted companies in Nigeria in 2013, only 4 were joint (Okaro & Okafor, 2013). This could be due to the absence of regulations that necessitate such arrangement. The push for joint audit system in Nigeria is not new. The Institute of Chartered Accountants of Nigeria (ICAN) has, through its 50th President, initially pushed for mandatory joint audit but jettisoned the idea after due consultations at its forum of firms where it was unanimously agreed that there is no consensus on the benefits of mandatory joint audit arrangements (Ajeagbo, 2014; PwC, 2015). However, there is a recent pronouncement in section 19.2.1 of the Financial Reporting Council of Nigeria (FRCN) in 2016 mandating all listed and significant public interest entities to engage joint auditors. It was pointed out that such entities must be those with market capitalization not less than N1 billion and / or whose annual turnover is not less than N10 billion. This pronouncement led to criticism from investors and other stakeholders. The Nigerian government was eventually compelled to suspend the implementation of the Code. (The Guardian, 2016).

Prior studies gave a mixed opinion on the effect of joint audit on audit quality. Some present positive findings on joint audit like Andre, Brog, Pong & Schall (2009); Mazers (2010); Okaro, Okafor & Ofaegbu (2015) and Bisogno and Da Luca (2016), while some opposed and claimed that joint audit cause free rider problems and do not live up to good enough effects (Neveling, 2007, Jinadu, Ojeka & Agbeyengi 2015). The inconclusive evidence demonstrates that the full impact of mandatory joint audit is still not clear. Generally, the issue of adopting joint audit is highly controversial and it must be well articulated and researched upon before an informed decision can be taken (Zeni, Haapamaki & Jarvinen, 2012; Asien, 2014). There is little evidence in literature that joint audits add to audit quality but they would necessarily increase audit fees. Therefore, this study sought to investigate the effect of mandatory joint audit on audit quality in Southwestern Nigeria. Our motivation for this study was the recent call by the Financial Reporting Council of Nigeria (FRCN) mandatory joint audits for firms and scanty empirical study in developing counties like Nigeria on the effect of mandatory joint audit on audit quality.

B. Literature Review

Audit quality is no longer a new concept under the scope of auditing. However, up till now there is no universal definition that people can agree upon unanimously. The most widely used definition of audit quality is by DeAngelo (1981), stating that “the quality of audit services is defined to be the market - assessed joint probability that a given auditor will both (a) discover a breach in the client’s accounting system and (b) report the breach”. Thus, it is the competence and integrity of the auditor that affects the quality of audit. The quality of audit will also affect the quality of financial reports (Dabor & Ibadin, 2013).

Proponents of joint audit argue that joint audit increases audit quality and opponents argue that the cost outweighs the benefits. According to the European Commission, joint
Audits can help ‘dynamise’ the audit market because it allows for smaller audit firms to have an opportunity to audit big companies and thus reduce the dominance of the Big Four. 

(European Commission, 2010). On the other hand, the opponents of joint audits often claim that joint audits will result in higher audit costs and thus higher audit fees. 

Thinggaard and Kiertzner (2008) examined how joint audit affects audit fees in Denmark. The authors found that two independent auditors that audited one firm in a competitive environment is likely associated with reduced audit fees. This association is only significant for large companies in Denmark. Zerni, Haapamark, jarvinen and Niemi (2012) examined the impact of voluntary joint audit on audit quality in Sweden. The authors found that Swedish firms that choose joint audit voluntarily are associated with higher audit quality.

In an analytical paper, Deng, Siminic, and Ye (2014) examined the consequences of joint audit on aspects of audit quality: auditor independence and audit evidence precision. They developed an analytical model to compare three scenarios: single audits by a big four audit firm; joint audits by two of the big four audits firms, and joint audits by one of big four audit firms paired with a smaller auditor. The authors identified three key findings. First, their analysis suggests that joint audits may compromise auditor independence as it gives clients the opportunity for ‘opinion shopping’. Second, when a technologically less efficient audit firm (a small firm) is chosen, audit quality may be impaired since a free-rider problem (i.e. an auditor relies on the other auditor’s work) would prevent and result in lower total audit evidence precision. Third, they also analyzed the cost consequences of joint audit and argued that audits fees under joint audits should be lower than under single audits when the technological difference between the two audit firms is small and/or when the big bears a large proportion of audit costs.

Asien (2014) argued that clients’ predisposition to pay higher remuneration to joint auditors is suggestive of a higher perceived quality of services rendered by joint auditors in comparison with a single audit. His finding shows that auditors’ remuneration is significantly higher for joint audit regimes than for single audit regimes. Jinadu, Ojeka and Agbeyengi (2015) examined the decision to engage two audit firms to conduct a joint audit and concluded that it would be associated with audit quality and earnings quality in Nigeria. The data on the perception of accounting academics and professionals were gathered through the use of a structured questionnaire. Their findings revealed that the engagement of joint auditors would not contribute positively to audit quality, higher earnings quality and would increase the cost of audit. Okaro, Okafor and Ofoegbu (2015) examined the perceptions of Nigerian accountants, auditors and accounting academics on the effect of joint audit on audit quality. Responses to the question were analyzed using Mean and ANOVA test statistics. The results of their finding show that the introduction of joint audit will positively affect audit quality.

Similarly, Okaro, Okaro and Ofoegbu (2018) reviewed the benefits and costs of joint audits and ascertained the perceptions of stakeholders as an important determining factor as to whether Nigeria’s government should make joint audits mandatory. The study revealed little agreement among stakeholders on the desirability of mandated joint audits in Nigeria.

Andre, Broye, Pong and Schall (2015) investigated how the audit fees of mandatory joint audits in France is different from audit fees of singular audits in the UK and Italy. Andre et. al (2015) found that mandatory joint audit in France leads to higher audit fees compared with the audit fees by single audits in the UK and Italy. Velte and Azibi (2015) investigated the impact of joint audits on audit quality. The authors collected data from Thomson financial database. Data were chosen from France and Germany for the period of 2008-2012. The main result shows that a clear positive link between joint audits and audit quality cannot be found, but there is strong evidence for higher audit costs which could lead to an increased price competition.

Bisogno and De-Luca (2016) investigated the effect of a joint audit system on the quality of a firm’s financial statements. The result of their findings showed that joint audit system positively affects earnings quality and the reliability of financial statement. Lesage, Ratzinger-Sakel and Kettuneu (2016) examined the effect of joint audit on audit fees in Denmark. These authors found that mandatory joint audit is associated with higher audit fees. Prior research has found that voluntary joint audit is associated with higher audit quality but
mandate joint audit is not associated with higher audit quality (Velt & Azibi, 2015; Zerni, Haapamaki, Jarvinen & Niemi, 2012.)

C. Theoretical Framework

The theoretical framework for this study is centered on The Agency Theory. It provides the main theoretical underpinning of the study and determines to a great extent the approach to be used in the study. For many years, it has been recognized that problems arise when a company’s ownership is separated from control. These managers, however, may not always act in the best interests of the shareholder in this so-called ‘principal-agent relationship’. This is the basis of the agency problem, which then gives rise to agency costs. Agency theory is a useful economic theory of accountability, which helps to explain the development of the audit. An audit is intended to minimize agency costs. It does so because independent specialist auditors can monitor the managers’ behavior, reporting more effectively and efficiently than the principals (Godfrey, Hodgson & Holmes, 2003). From an agency theory perspective, Dang (2004) argues that audited financial statements are monitoring mechanisms to provide assurance for users of financial information. There are various mechanisms that may be used to try to align the interest of agents with principals and to allow principals to measure and control the behavior of their agents and reinforce trust in agents. Monitoring costs (Audit fees) are incurred to ask external auditors to verify the financial statements prepared by management. However, the agency model would suggest that agents are untrustworthy. Like directors, auditors will have their own interests and motives to consider.

The principal/agency literature suggests that hired managers will not have the same objectives as profit-oriented private owners; rather they will use firm’s specific rents to satisfy their own maximands (Oyejide & Soyibo, 2001). According to these authors, the main issue in the principal/agency literature is centered on asymmetric information because outside owners do not have access to full information on corporate performance or the reasons for under-performance. The separation of ownership and control, which occurs as a result of the introduction of external investors, brings to the force the agency problems. Managers are expected to represent the interest of the external owners (Oyejide & Soyibo, 2001). Therefore, the agency relationship provides a vehicle to analyze the effect of mandatory joint audit on audit quality among insured Deposit Money Banks in Nigeria.

Methodology

This study employed a survey instrument. The questionnaire developed has two sections. Section A has three questions about the respondent’s gender, title of job and year of experience, while Section B comprised questions relating to the objectives of the study. The study population comprised of the Accountants in academic and those in practice in Southwestern Nigeria.

For populations that are large or undefined, Cochran 1963, cited in Babatunde 2016, developed a model to determine the sample size since the population of Accountants in academic and those in practice Southwestern Nigeria defined as:

\[
 n_0 = \frac{Z^2 pq}{e^2}
\]

where \( n_0 \) is the sample size, \( Z \) is value of the normal curve that cuts off an area \( a \) at the tails (1 – \( a \) equals the desired confidence level, e.g 95%), \( e \) is the desired level of precision, \( p \) is the estimated proportion of an attribute that is present in the population, and \( q \) is 1 – \( p \). Therefore, the Accountants in academic and those in practice sample size for the study desires 95% confidence level and 7.5% precision. \( Z = 1.96 \), \( P = 0.75 \), \( Q = 1 - P = 0.25 \), \( e = 0.05 \)

\[
 n_0 = \left( \frac{(1.96)^2 \times 0.75 \times 0.25}{0.05^2} \right) \quad n_0 \text{ shows that at least 288 accountants must sampled.}
\]

The samples were selected using Purposive sampling techniques. The results reported in this study are based on the responses from 252 out of 300 respondents. The questionnaire was designed in a 5-point Likert scale ranging from (1) strongly disagree to (5) strongly agree requesting respondents to rate their level of agreement on each statement in the questionnaire. Data gathered were analyzed using T-test and ANOVA.
D. Results and Discussion

Table 1 indicated \(t\)-test = 1.311 at \(p\)-value = 0.217, this implies that the difference in means is not statistically significant since the \(p\)-value is greater than 0.05 level of significance. Also the ANOVA result \((F = 1.924 \text{ at } p\)-value = 0.143) further indicated that making joint audit compulsory in Nigeria does not guarantee an improvement in the audit quality. The result corroborates the work of Zerni, et al (2012) who found out that the Swedish firms that choose joint audit voluntarily are associated with higher audit quality, it also aligns with the work of Deng et al (2014) who found out that joint audits may compromise auditor independence. Other studies that this work corroborates are Jinadu et al (2015), Velte and Azibi (2015). Jinadu et al (2015) findings revealed that the engagement of joint auditors would not contribute positively to audit quality, more so, the findings from the study conducted by Velte and Azibi (2015) revealed that there is no clear link between joint audits and audit quality.

However, the result is not in agreement with the study conducted by Okaro et al (2015) who found out that joint audit will positively affect audit quality.

Table 1: Independent Samples Test

<table>
<thead>
<tr>
<th>Levene’s Test for Equality of Variances</th>
<th>t-test for Equality of Means</th>
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</thead>
<tbody>
<tr>
<td>F</td>
<td>Sig.</td>
</tr>
<tr>
<td>Equal variances assumed</td>
<td>2.686</td>
</tr>
<tr>
<td>Equal variances not assumed</td>
<td>1.131</td>
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</tbody>
</table>

Source: Researchers’ computation, 2018

Table 2

ANOVA

<table>
<thead>
<tr>
<th></th>
<th>Sum of Squares</th>
<th>Df</th>
<th>Mean Square</th>
<th>F</th>
<th>Sig.</th>
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</thead>
<tbody>
<tr>
<td>Between Groups</td>
<td>8.664</td>
<td>4</td>
<td>2.166</td>
<td>1.924</td>
<td>.107</td>
</tr>
<tr>
<td>Within Groups</td>
<td>278.082</td>
<td>247</td>
<td>1.126</td>
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<tr>
<td>Total</td>
<td>286.746</td>
<td>251</td>
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</table>

Source: Researchers’ computation, 2018

E. Conclusion and Recommendations

Mandatory joint audit would diminish audit quality and make the financial reporting less reliable. The “four eyes” principle, which is frequently highlighted by those promoting joint audits as being the key to adding greater security to the audit, is in fact limited in a joint audit arrangement to a reviewed and exchange of conclusions. The study therefore recommends that joint audit should not be made mandatory. The choice of the number of auditors is the responsibility of shareholders and audit committee who may appoint joint auditors if they believe it would add value to the company.

References


Appendix

Questionnaire

Kindly provide your view on the understated statements as regards the effect of mandatory joint audit on audit quality in Nigeria.

Section A

(i) Gender:
(ii) Title of Job:
(iii) Years of Experience:

Section B

Key: Strongly Agree is 5, Agree is 4, Undecided is 3, Disagree is 2 and Strongly Disagree is 1

<table>
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<tr>
<th>s/n</th>
<th>Statement</th>
<th>5</th>
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<tbody>
<tr>
<td>1</td>
<td>Joint audit improves the quality of audit as two heads are better than one</td>
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<td>2</td>
<td>Joint audit gives opportunities for more auditing firms to enter the market</td>
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<td>3</td>
<td>A Joint audit produces higher costs than a single audit</td>
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<tr>
<td>4</td>
<td>An auditor’s independence is higher in a joint audit</td>
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<td>5</td>
<td>There is a danger of “free riders” in a joint audit</td>
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<td>6</td>
<td>On the whole, the benefits of Joint audits outweigh its costs</td>
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<td>7</td>
<td>Making joint audits compulsory in Nigeria will improve audit quality.</td>
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<td>8</td>
<td>Joint audits should be made mandatory for all companies in Nigeria.</td>
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<td>9</td>
<td>The mutual review of the audit process in a joint audit strengthens the audit opinion</td>
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<td>10</td>
<td>Voluntary Audit Arrangement is preferred</td>
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