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RESEARCH ARTICLE

AUDIT SELECTION REGIME AND AUDIT MARKET CONCENTRATION IN A DIVERSIFIED ECONOMY: EVIDENCE FROM NIGERIA

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ABSTRACT

This study evaluates the effect of audit selection regime on audit market concentration in Nigeria. It used cross sectional data collected from 91 non-financial firms quoted on the Nigerian Stock Exchange. The independent variables used for the study are, audit rotation, audit tendering and audit switching. Audit market concentration is the dependent variable. The data collected were analysed using descriptive statistics, correlation and regression analysis (white). The result finds that audit rotation, audit tendering and audit switching have significant effect on audit market concentration in Nigeria. The study therefore concludes, that audit selection regime has significant effect on market concentration and recommend that regulatory agencies in Nigeria should make policy that will regulate the audit selection regime in other to reduce the dominance of the big four audit firms and restrict the switching from one big four to another big four, thereby giving the non-big four audit firm opportunity to reducing the audit market concentration.

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INTRODUCTION

Audit market though similar to some market for services, has its unique characteristics. The market plays a crucial role in ensuring transparency, investor confidence and in improvement of capital markets. Since the demand for audit service is compulsory as a result of the legal obligation on firms to use audit service, the market is said to be ever expanding market as the economy expands. Notwithstanding, audit quality can diminish with long audit tenure (Firth *et al.,* 2010), hence the mandatory rotation which is geared toward reducing familiarity threat, ensures auditors independence, provides a greater skepticism and a fresh perspective that may be lacking in long-standing auditor client relationships. According to Klynsmit, Wallage and Arnie (2015) the extent to which auditor selection regime's impact audit market concentration largely depends on who has the power of appointment in the prospective client firm. Most empirical studies like Cohen, Krishnamoorthy, and Wright (2010), Fiolleau, Hoang, Jamal, and Sunder (2013) believe that management exercises the power of appointment of auditor but best practice and law require the audit committee to handle such function to avoid independence threat. In Nigeria, the power to appoint auditor is the responsibility of the audit committee, couple with the mandatory selection regime, it is expected that familiarity threat, independence and self-interest threats will reduce the audit market concentration. However empirical evidence on the extent to which audit selection regime affect the audit market concentration is still lacking in the Nigeria context. The adoption of the international financial reporting standard in Nigeria has increased the demand for the services of the Big four audit firms due to the perceived competency and manpower to handle the complex nature of the new standard, this has resulted in lopsidedness in the distribution of the audit market share (market concentration) between the big four and the non-big four. On the other hand, the mandatory selection regime introduced by the regulatory agency as a way of reducing the familiarity threat and market concentration has not effectively impacted on the market concentration as most firms switch from one big four to another. Few empirical works on audit market concentration were focused on the impact on audit quality. Examples are, Maja and Amela (2016), Jere, Michas and Scott (2013), Patrick and Markus (2013), Sanjay, Srinivasan and Yoonseo (2010), Benjamin and Ulrike (2012), Sanja and Mateja (2015). None of the studies was conducted in Nigeria. Thus the aim of this study is to evaluate the extent to which audit selection regime affect audit market concentration in Nigeria context. The paper is structured into five sections. Following this introduction, section two, reviews of related literature. Section three deals with Methodology. Section four, result of analysis, conclusion and recommendation.

Review of related literature

Conceptual Framework: Audit market concentration is characterized by the oligopoly of the big four audit firms among other audit firms be it small or medium. It deals with the dominance of the big four audit firms. The term concentration as used by Moeller and Hoellbacher (2009) describes the agglomeration of audit market economic power on few audit firms.

Auditor's Tendering: This is the periodic offering of audit engagement up for prospective and competitive proposals by different audit firms. Such that any audit firm who is selected through the selection process will hold the position for the next one year however, the current firm may continue in that position in subsequent years if selected (Lu and Sivaramakrishnan, 2009). The mandatory rotation of audit firm requires quoted firms to throw open new tender for audit firms to bid for once in every ten years. Under the Nigeria company law, tenure of an audit firm is renewed by simple majority vote at the annual general meeting of the company.

Auditor Selection Regimes: Auditor Selection Regimes is the process of changing an auditing firm that has served in a given year. This deal with the restriction of audit tenure of a firm to maximum determined period of years, in Nigeria, the number of years an audit firm can occupy it position is ten years. After wish the auditor selection process will begin with the opening to other audit firm to bid for. In the view of Lu and Sivaramakrishnan (2009) the auditor selection regime has the capacity of enhancing the rotation of the audit firm as a potent tool for reducing familiarity threat.

Audit rotation and Audit tendering: Audit rotation and tendering though similar in many respect, there are some difference between them, the main difference relates to who is qualified to bid for the tender throw open. Under the audit rotation, the present auditor is to be mandatorily changed once in every ten years, while under the tendering, the incumbent auditor can be reappointed. Thus, in the case of tendering, the current auditor has the right to bid as a potential candidate for reappointment (which is contrary to rotation tenet) but has to formally compete for the assignment with other audit firms.

Audit tendering and audit market concentration: In a recent study by Jere, and Scott (2013) two separate dimensions of audit market concentration were examined: Firstly, the degree to which the Big 4 auditing firm's dominant the market shares relative to other auditing firms. Secondly, how the degree of supply is concentration is centered within the big four audit firm. That is, the unequal market shares among the Big four auditing firm within an economy. Tendering which entail a periodic offering of audit engagement up for prospective and competitive proposals by different audit firms. Such that any audit firm who is selected through the selection process will hold the position for the next one year however, the current firm may continue in that position in subsequent years if selected (Lu and Sivaramakrishnan, 2009). One of the main aims of audit tendering is to increase auditor competition and independence by restricting the length of period of audit firm tenure in other to reduce or eliminate familiar threat. However, in the work of Sanja and Mateja (2015), it was observed that in most countries, the supply side of the audit market is highly concentrated, which has a serious implication on the nation economy as they are dominated by unique set of audit firms. However, in the study of Boone, Khurana and Raman (2012) an alternative about audit market concentration, was found, the study found that audit market concentration can increase rather than decreasing audit quality because audit market concentration was found to increase auditors independent. In line with the finding, a related empirical study carried out in German and Dutch audit market by Buijink, Maijoor and Meuwissen (1998) founds that high levels of audit concentration do not mean and does not reduce the level of competition and the increasing level of competition can lead to an increasing audit market concentration.

The study therefore, hypothesized that:

H0: Audit tendering has no significant effect on audit market concentration in Nigeria.

Audit rotation and audit market concentration: Audit rotation is the mandatory change of audit firm once in every ten years. The European Commission (2014), believe that the mandatory rotation of audit firm can be useful tool in reducing familiarity threat, limit the risks of repeated errors, and strengthen the conditions for genuine audit skepticism which is good for enhancing reporting quality. The mandatory rotation of audit firm will require all the quoted firms in the Nigeria stock exchange to throw open new tender for audit firms in every ten years. Firth, Rui and Wu, (2010), Hyeeso, (2004) argued that audit quality can diminish with long audit tenure, hence the mandatory rotation geared toward reducing familiarity threat, ensures auditors independence and provides a greater scepticism and a fresh perspective that may be lacking in long-standing auditor client relationships. The term concentration as used by Moeller and Hoellbacher (2009) describes the agglomeration of audit market economic power on few audit firms. According to Porter (2008), the audit market concentration is a strategic competitive advantage that an audit firm enjoys which provide a higher additional benefit for the client. Patrick and Markus (2013) believe that with the increasing supplier concentration of the big four audit firm, the market power of big audit firms is on the increase such that the collective market dominance and the price arrangements between the Big Four audit firms are possible in the course of cartelization. Hence the concentration can be a possible cause of an oligopoly or monopoly of the audit market. The mandatory rotation of audit firms became necessary as it is seen as a tool for preventing familiarity threat and as an avenue for another auditor to have a fresh look at the annual financial report of the firms been audited and promote independence and quality. The study of Kramer, Georgakopoulos, Sotiropoulos, and Vasileiu (2011) finds that audit reporting conservatism tend to reduce as audit firm tenure increases, the study believes that the mandatory rotation has the capacity of enhancing reporting conservatism. Cameran, Francis, Marra, and Pettinichio (2015) evaluates the nexus between mandatory audit firm rotations on audit quality of quoted companies in Italy. The study finds that a negative relationship exists between mandatory audit firm rotation and the audit quality especially at the early tenure. But the findings from a related study carried out by Korea, (2004) shows that the level of discretionary accruals decrease with mandatory audit rotation. Asein (2007) in a related study on the impact of mandatory audit rotation on financial statement reporting quality believed that the mandatory audit rotation of has a positive impact of reporting quality of firms, hence it can be a potent tool for dealing with familiarity threat. The study therefore, hypothesized that.

H0: Audit rotation has no significant effect on audit market concentration in Nigeria.

Auditor switching and audit market concentration: Firm chooses an auditor that best meets that firm's incentives. For example, firms with complex operations choose larger audit firms because of their efficiency and capacity to audit such clients. Similarly, because large audit firms charge higher audit fees, smaller clients are likely to choose the smaller auditors (Moizer 1997; Choi *et al.,* 2008). Moreover, the clients' audit-related incentives also vary and may include superior audit quality or willingness to allow aggressive reporting (Williams 1988). Additionally, client firms' incentives are not static. As firms expand or contract, they become more or less reliant on external investment, branch out into new industries, expand internationally, or downsize and become more specialized. As a consequence of fluctuating competitive and operational environments and changing firm characteristics, client firms must continually evaluate which auditors match their incentives (Johnson and Lys 1990). One of the main factors that have favored the big audit firm is the adoption of the international financial reporting standard. The implementation of the standard has enhanced the switching from small audit firm to big audit firm. Specifically, the agency issues between shareholders and client firms' managers may become more pronounced because investors are uncertain of the quality of first-time. Despite the high charges by big four auditors most companies still prefer using them because of the perceived client confidence that is reposed on them (Joos and Leung 2013). In confirmation, the study by Comprix *et al.,* (2011), shows that larger clients are more likely to switch from small auditors to the big four. Hence the audit switch resulting from the accounting standard adoption has increase the market concentration of the big four audit firms. The study therefore, hypothesized that:

H0: Audit switching has no significant effect on audit market concentration in Nigeria

Theoretical framework: Game theory was formulated by Neumann and John in 1950 to explain the relationship that exists between selection conflict and cooperation rational decision making. Game theory is applicable to a large area of behavioral relations which form a basis for rational decision making. Under the game theory, a game is considered to be cooperative if the players are able to form binding commitments that can be externally enforced. The cooperative game describes the structure, strategies and payoffs of coalitions. On the other hand, a game is non corporative if the players cannot form alliances that can be externally enforced. The non-cooperative game theory focused on how selection procedures will affect payoffs within each group. The big four are considered to be an important cooperative due to their ability to form alliance and detect the trend and pace of things in the audit industry. They dominate the industry due to their experience, assets and client coverage. Most of the empirical works reviewed, focus on audit market concentration and its impact on audit quality only few was done on audit market concentration and audit selection regime.

The study observed that empirical study on the effect of audit selection regime on audit market in Nigeria context is lacking. Those studies that have been carried out on audit market concentration and audit selection regime, used different scope, while others were based on cross countries evidence, hence the contradiction in their findings. There is empirical gap on the effect of audit market concentration on audit selection regime in emerging market context like Nigeria. Hence the need for a study like this, aimed at investigating the extent to which audit selection regime affect the audit market concentration in Nigeria context.

MATERIALS AND METHODS

Research design: The study used cross sectional data and was based on ex-post facto research design. Using secondary data collected from all non-financial firms in 2016 financial years. The population of the study is the 119 non-financial firms quoted in the Nigerian Stock Exchange. The sample size of the study consists of 91 quoted non-financial firms in Nigeria. The study used Taro Yemeni formula to determine the sample size of 91 from the population of 119 quoted non-financial firms in Nigeria.

Taro Yemeni formula:

$$\mathrm{N} = \frac{\mathrm{n}}{1+\mathrm{N}(\mathrm{e})^2}$$

$$= \frac{119}{1+119(0.05)^2}$$

$$= \frac{119}{1.2975}$$

$$= 91.538$$

The study used cross sectional data collected from the quoted non-financial firms. Sanja and Mateja (2015) describes the audit selection regime in three stages: audit rotation, audit tendering and current regime. The variables and their proxy were operationalized as follows. Below are the dependent and independent variables and their proxy.

Variables	Measures/Proxy	Authority
Audit market concentration (AUDMKTC)	Audit concentration rate: Market share of the big four to total audit market	Sanja and Mateja (2015)
Audit rotation (AUDROT)	Number of years auditor engagement	Sanja and Mateja (2015)
Audit tendering (AUDTEND)	Number of audit firm tender for new engagement.	Sanja and Mateja (2015)
Audit switching (AUDSWIT)	Binary: From non big four to big four (1) From big four to non big four (0)	Chan (2006),
Firm Size ((FSIZE)	Log of total assets (control variable)	Shin (1998)

Model Specification

The model for the study is premised on the main objective and anchored on the sub-objective. The model used was adopted from the work of Gold *et al.* (2015). The Gold *et al.* (2015) model: INVD = *f*(AUDROT, TEND); where INVD is investment decision; AUDROT is audit rotation and TEND is audit tendering. The Gold *et al.* (2015) model is modified to suite the mediating variables used in this study.

The model for the study is anchored on the objective.

$$AUDMKTC = f(AUDROT, AUDTEND, AUDSWIT, FSIZE,) \quad \ldots\ldots\ldots\ldots\ldots 1$$

$$AUDMKTC_i = d_0 + d_1AUDROT_i + d_2AUDTEND_i + d_3AUDSWIT_i + d_4FSIZE_i + \mu_i \quad \ldots..2$$

Equation 1 is the linear regression model used in testing the null hypotheses.

Where: AUDMKTC = Audit market concentration; AUDROT = Audit rotation; AUDTEND = Audit tendering; AUDSWIT = Audit switching; FSIZE = Firm size; $d_{0,}$ = Constant; $d_1 \ldots d_4$ = are the coefficient of the regression equation; μ = Error term; *i*= is the cross section of firms used.

DATA ANALYSIS AND INTERPRETATION

This study investigated the effect of audit selection regime on audit market concentration of all quoted non-financial firms in Nigeria. In analyzing the data, the study adopted multiple regressions (white) to identify the possible effect that audit selection regime (audit rotation, tendering and switching) has on the market concentration. The study conducted some preliminary analysis such as descriptive statistics and correlation analysis.

Descriptive statistics: Table 1 shows the mean (average) for each of the variables, their maximum values, minimum values, standard deviation and the Jarque-Bera (JB) statistics (normality test). The result provided some insight into the nature of the selected companies that were used for the study. Firstly, it was observed that within the period under review, market concentration was about 0.6725 has a maximum and minimum value of 0.6750 and 0.4750respectively. The mean value indicates that the big four audit firms render accounting service to about 67% of the total companies quoted in the Nigeria Stock Exchange.

The table shows mean value of audit rotation of 5.0220, maximum and minimum 9.000 and 1.0000 respectively. This value indicates that the audit firm retains its contract on the average for 5 years, maximum period of 9 years and minimum period of one year. The table also reveals that tendering has the mean value of 4., maximum value of 7 and minimum value of 3. This reveals that whenever, an audit opportunity is open, on the average about four audit firms apply for it. The result shows that on the average about thirty-seven percent of the firms in Nigeria changes their audit firm annually. Firm size has a mean value of 18.257, maximum value of 27.330 and minimum value of 7.1000. This indicates that the firm used for the study are not homogenous. The large different between the maximum and minimum value of firm size show that some firms are large while some are small. Lastly, the Jarque – Bera (JB) which test for normality or the existence of outlier or extreme value among the variables shows that all the variables are normally distributed at 1% level of significance. While audit market concentration and audit rotation are not normally distributed.

Correlation analysis: In examining the association among the variables, the study employed the Pearson correlation Coefficient (Correlation analysis).

The use of correlation matrix is to check for multi-collinearity and to explore the association among the variables used for the study. The Table 2 shows the relationship that existed among the various AUDMKTC, AUDROT, AUDSWIT, AUDTEND, and FSIZE. The correlation analysis table shows that there is a positive association between AUDMKTC, AUDROT, AUDSWIT and AUDTEND. This suggests that in the model used for the analysis, the entire explanatory variable have positive influence on the dependent variable. In checking for multi-collinearity, the study observes that no two variables were perfectly correlated. This means that there is absence of multi-collinearity problem in the model used for the analysis.

Regression Analysis

The regression analysis was used to test for the effect of the audit market selection regime on audit market concentration.

Data Analysis: Regression analysis result (White hetero-skedasticity-consistent): The Table 3 report, the OLS regression result.

Table 1. Provides the summary of the descriptive statistics analysis result

Variables	Mean	Max	Min	Std Dev	Jarque Bera (JB)	JB (P-value)
AUDSWIT	0.3736	1.0000	0.0000	0.4864	15.449	0.0004
AUDROT	5.0220	9.0000	1.0000	1.8011	0.5797	0.7483
AUDTEND	4.3846	7.0000	3.0000	0.9634	3.0056	0.2225
AUDMKTC	0.6725	0.6750	0.4750	0.0212	26847.7	0.0000
FSIZE	18.257	27.330	7.1000	5.4936	4.4299	0.1092
		Observation		-	91	

Sources: Researcher's summary of descriptive statistics 2018

Table 2.

	AUDMKTC	AUDROT	AUDSWIT	AUDTEND	FSIZE
AUDMKTC	1.000000				
AUDROT	0.077255	1.000000			
AUDSWIT	0.060362	-0.060204	1.000000		
AUDTEND	0.173524	-0.081764	-0.001824	1.000000	
FSIZE	-0.056172	0.060612	-0.115448	0.086399	1.000000

Source: Correlation analysis e-view 8.5

Table 3.

Variables		
C		0.6750 [2.111] (0.000)
AUDROT		-8.5016 [4.1946] (0.0001)
AUDTEND		1.9715 [4.9325] (0.0000)
AUDSWIT		1.0515 [1.7461] (0.0844)
FSIZE		1.7216 [2.8284] (0.0058)
Durbin Watson	2.1111	
R.Sq (Adj)	0.6129	
Wald F-Stat	7.1987	
Wald Stat prob.	0.0000	

Source: Researcher (2018) summary of multiple regression analysis result.

The OLS result follows the assumption of non-homogeneity hence the problem of hetero-scedaticity. in order to solve the problem, the study R-sq(Adj.) 0.6129 (61.29%) this indicates that all the independent variables jointly explain about 61% of the variation/changes in audit market concentration of quoted non-financial firms in Nigeria. Hence about 61.29% of changes in audit market concentration can be attributable to audit selection regime of the firms used in the study. The Wald F-statistics value 7.1987 and its probability value of 0.000 shows that the model used was appropriate and is statistically at 1% levels. The Durbin Watson statistics result was 2.1111 can be approximated into 2, this indicates the absence of autocorrelation in our model, it reconfirms the appropriateness the model used for the study. The result of the effect of audit rotation on audit market concentration shows that audit rotation has significant effect on audit market concentration. It indicates that the more regulatory agency enforces mandatory rotation of audit firm the lesser the audit market will be concentrated in the hands of the big four audit firms. This finding is in line with the study of Gold *et al.* (2015) and Sanja *et al.* (2015) but contrary to the finding of Benjamin *et al.* (2012). The effect of audit tendering on audit market concentration reveals that audit tendering has a significant effect on audit market concentration in Nigeria. The more tenders a company receive from audit firm, the better the option they may make, hence the tendering process has significant effect on the audit market concentration. This finding is in line with that of Gold *et al.* (2015) and Sanja *et al.* (2015) but contrary to that of Sanjay *et al.* (2010). The result of the analysis reveals that audit switching has significant effect on audit market concentration in Nigeria. Switching from audit firm to another has significant effect on the audit market concentration. This is contrary to the finding of Maria (2013).

Summary of Findings

The following are the key finding from the study:

- The study finds that audit rotation has significant effect on audit market concentration in Nigeria. This indicates that audit rotation can be a potent tool to reducing audit market concentration in Nigeria.
- The study finds that audit tendering has a significant effect on audit market concentration in Nigeria. This shows that the more tenders a company receive from audit firm, the better the option they may make in their selection. This has significant effect on the audit market concentration.
- The study finds out from the result that audit switching has significant effect on audit market concentration in Nigeria. Switching from audit firm to another significantly affect the audit market concentration in Nigeria.

Conclusion

In other to eliminate the familiarity threat and ensure audit independence regulatory agencies has introduced audit selection regime as a major strategy. This can also be a tool for reducing audit market concentration. Hence most regulatory agencies legally instituted a limit of ten years for any audit contract beyond which the contract cannot be renewed. The dominance of the big four over the accounting and auditing sector has been an issue especially after the adoption of the International Financial Reporting Standard which gave them a fair advantage over the smaller audit firm. The extent to which the audit selection regime affects the audit market concentration in Nigeria is the aim of this study. Our study found a positive effect of audit selection regime on the audit market concentration in Nigeria.

Recommendation

Based on the findings, the study recommends the following:

- A variety of audit rotation mechanisms geared toward decreasing audit market concentration and increasing competition should be introduced.
- Regulatory agencies in Nigeria should make a policy that restricts the switching from one big four to another big four, thereby giving the non-big four audit firm opportunity and reducing the audit market concentration.
- Audit tendering procedure and time should be elongated in other to allow more audit firms to submit their tender and promote competition among the big four audit firms.

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