DETERMINANTS OF AUDITORS’ REMUNERATION IN NIGERIA: EVIDENCE FROM QUOTED FIRMS ON THE NIGERIAN STOCK EXCHANGE

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Abstract: External users of financial statements have to rely on the trust reposed on the independent auditor’s expressed in an opinion on financial statements to make investment decisions and hence the importance of independent auditors in financial reporting. Nevertheless, this trust might be broken unethically and thus raises the questions of what determines independent auditors’ remuneration in Nigeria. Our sample consists of twenty two firms drawn across the sectors classification of firms on the Nigerian Stock Exchange. Our model drawn from past studies included variables such as size of the firm, the characteristics of the auditor, profit, ratio of inventory plus accounts receivable divided by total assets to evaluate the determinants of auditors’ remuneration in Nigeria. Our multiple regressions result opposes the findings of past studies that size is a major determinant of auditors’ fees. However, our findings also reveals that auditor type (BIG4) is the characteristics of the auditor; the level of profitability; and firm liquidity are the determinants of auditors’ remuneration in Nigeria.

1.0. INTRODUCTION
Public companies are managed by people who are not owners of the business. The full separation between ownership and management and the development of stock market make a need for owners’ and investors to supervise business results reflected in financial statements reported by company management. The company management has the responsibility to report business results to the owners and other users of the financial statement. They therefore decide the information presented in company’s financial statements. Thus, external users of the financial statements have to rely on the auditor’s opinion delivered on the financial statements. The importance of auditors, especially in this era of globalization, makes a steadier and larger market for auditing services (Hayes, et al, 2005). Since the ownership is separated from management, the running of firms is therefore based on trust relationship. Nevertheless, this trust might be broken as management might act in their own best interests instead of that of the owners who have deployed their capital in the business. This phenomenon is known as agency problem. This raised the issue for an external party to keep management in check and to ensure that procedures and policies are in place to protect the interest of the owners and probable investors. Thus, regulators of publicly owned businesses in various countries make provisions for external auditing of public businesses.

In Nigeria, section 357 of company and Allied Matter Act (CAMA) provides ‘that at each annual general meeting every company shall appoint an auditor or auditors to audit the financial statements of the company and to hold office from the conclusion of that, until the conclusion of the next, annual general meetings. Section 360 of the act imposes a lot of responsibilities on the auditors. An auditor can only carry out these responsibilities if he is independent. He must ensure that he is free from any influence which will militate against the discharge of his duties unethically. He must be in a position to give honest and unbiased opinion at all times (Nwabueze, 2000). Traditionally, one major element that impairs audit independence is audit fees. It may benegative abnormal audit fees or positive abnormal audit fees, i.e under or over pricing audit services.
The remuneration of the auditor may be fixed at the time of appointment or left to be decided at the completion of the audit. This is because it is not easy to determine the complexity of an audit at the initial stage. According to Nwabueze (2000) where the fee is to be decided upon completion of the audit, it is advisable for the auditor at the time of appointment to state some basis of remuneration. The question therefore is, what company characteristics are considered to determine the basis of the auditor(s) remuneration? What are the determinants of audit fees in Nigeria?

Several studies on the determinant of audit fees have been carried out in developed countries while there have been little of such work in the developing countries. This study therefore, empirically evaluates the company characteristics that serve as the determinants of audit fees for firms quoted on the Nigerian stock exchange. The rest of the paper is organized as follows: given the introduction, section two reviews literature as related to the study while section three outlines the methodological framework. Section four presents the empirical findings while the paper is concluded in section five.

2.0. LITERATURE REVIEW
Auditing fees are the amount a company pays an external auditor in exchange for performing an audit. It is the price charged for the audit services by audit firms. The International Standards on Auditing defines Audit fees as “the amount that remunerates the financial auditor’s activity, the certification of financial statements. These fees, according to the code of Ethics for professional accountants, should be calculated in an objective way and the auditor’s independence should not be influenced by them. A number of researches have been carried out on the determinants of audit fee. Most of the research findings show that the size and the complexity of the company are the major determinants of audit fees. Simunic (1980) developed a basic model for this. He constructed an economic model of audit fees, that includes five main explanatory factors which are (a) size of the auditee, (b) complexity of the audit, (c) auditing problems associated with certain financial statement components especially inventories and receivables, (d) industry of the auditee and (e) whether the auditee is a public or a closely held company. His empirical tests using regression model confirmed that the size of audit fee could be explained by the identified factors. Ole and Mogens (2010) analysed whether the application of international financial Reporting Standards (IFRS) has increased Danish Companies’ cost of auditing. A sample of financial reports from large Danish Companies from 2002-2008 was used. They found out that audit fees have not increased significantly for companies using IFRS rules. However when combining IFRS with company size and complexity, large and complex companies using IFRS pay a heavy audit fee premium compared to small and less complex companies that also use IFRS.

Rubin (1988) and Tinggard and Kiertzner (2008) used Simunic model to analyse the determinants of audit fee. Rubin result is similar to that of Simunic while Tinggard and Kiertzner (1988) result indicate that joint audits where both auditors have significant stakes in the audit reduce audit fees compared to audits where one auditor is dominant. Kamal and Rana (2007) investigated the structure of audit fees in Jordan. They ran a cross-sectional linear Ordinary Least Square (OLS) regression of the audit fees on corporate size, the status of the audit firm, the degree of corporate complexity, profitability risk, corporate accounting year end and the lag between the audit report and the end of the accounting year. The results of the analysis revealed that corporate size, status of the audit firm, industry type, degree of corporate complexity and risk are the main determinants of audit fees. However, variables like corporate profitability, corporate accounting year end and time lag between year end and the audit report date appeared to be insignificant determinants of audit fees. Nathalie and Alain (2000) in their study “the determinants of audit fee in French quoted companies“ found out that audit fees depend on firm size, firm risk, and the presence of two of the big four firms. Emiliano, Kenneth and Martin (2011) in their study, found out that size, risk and fees for non-audit services are the main determinant of audit-fee in the UK charity sector. According to them, contrary to research in the private sector, the organizational complexity of the charity did not seem to have significant influence on audit fees.
Joshi, and Bastaki (2000) examined audit fee structure in Bahrain for 38 companies. By analyzing the data concerning a number of variables representing size, risk, complexity, timing of audit, and profitability, a model was developed of the determinants of audit fees. The study strongly confirms that most of the previous research findings are also applicable to the Bahrian market and that audit fees are significantly associated with the size, risk, profitability and complexity of the Client Operation. Contrary to Emiliano et al (2011) Beattie, Goodacre, Pratt and Stevenson (2000) in their study to determine audit fee voluntary sector, confirmed the previous private sector company studies and concludes that size, organizational complexity and audit firm location are the major determinants.

Ramzy (1988) investigated the factor affecting the level of audit fees paid to companies auditors. He classified all the factors thought to be affecting the level of audit fees into three groups – size, complexity and others. The relative importance of these factors was determined empirically and statistically. The empirical study was undertaken by mailing two sets of questionnaires to samples of 100 companies and 100 audit firms. These questionnaires were used to assess the degree to which the factors previously identified were important determinants of the audit fees. Multiple regressions was also used to assess the magnitude of the association between size and complexity factors and audit fees. The results of both the empirical study, and the statistical analysis revealed that the company size (in terms of debtors, stocks, work in progress, turnover, creditors and total employment costs) and its complexity (in terms of number of subsidiaries, and number of countries in which the company operates) are the major objective determinants of audit fees.

Mohd (2005) wrote on the determinant of audit fees for SMEs in Malaysia and Implications of MIA Guidelines. In his literature, he compiled the organizational factors that affect the audit fee which are: auditee’s size auditee complexity auditee risk, auditee profitability and seasonality (auditor’s busy period). The main finding of the study was that only auditee’s size has a significant impact in the determination of audit fees for SMEs organizations for the years studied.

Dinh (2012) in his work, determinants of audit fees for Swedish listed non financial firms in NASDAQ OMX stockholder concludes that auditee size and other fees have positive correlations with audit fees and that audit committee presence has a negative relation with audit fees.

Marc (1988) adopted Simunic (1980) model to determine audit fee determinants of municipal. The empirical tests using regression analysis indicate that a significant portion of the variance in municipal audit fees is explained by the model.

Cuza (2012) identified the determinants of audit fees by testing the existence of a circular causality in the connection between audit fee and the financial performance of a NYSE-quoted company. Linear regression and variance analysis (ANOVA) were used for the analysis. The results indicate the existence of a circular causality, bidirectional, on the level of the relationship between audit fees and financial performance.

Bronson, Ghosh and Hogan (2009) compared the audit fees for a sample of foreign firms cross-listed in the U.S to those of U.S based companies. They found out that audit fees are increasing in measure of the strength of the regulatory environment. The results suggest the country-specific regulatory environment and the reconciliation to U.S GAAP are both significantly determinants of audit fees.

Rohami (2002) wrote on the determinants of audit fees: The case of the Banking Industry in Malaysia. The study examined the impact of non-audit services conducted by audit firms to the banks over audit fees. The results show that the variable of non-audit fees was statistically significant in determining audit fee.

Ming-Wei and Steven (1996) study, the determinants of Audit fees: Australian perspective aimed at
investigating if the factors of auditee size, audit complexity audit time, audit quality and audit risk could explain the variation of auditor fees. The study confirmed prior studies by concluding that auditee size appeared to be the most important factor explaining audit fee payments. Brinn, Peeland Robert (1994) conclude in their study of audit fee determinants of independent and subsidiary unquoted companies in the UK, that in line with the common findings of earlier studies on quoted companies the most significant factors affecting the audit fees of unquoted companies are auditee size and complexity. Lifschutz (2010) examined the association between corporate governance characteristic and external audit fees in large public companies in Israel. The results show that board independence and audit committee diligence are positively and significantly associated with audit fees.

De Fuentes Pucheta and Maria (2009) drew on Simunic (1980), and Cameron (2000) to identify factors that affect audit fees. Their model specification consider the following variables: non-audit fees; size (measured by total sales or turnover) Big 4; No of years the auditor has audited the financial statement of the company; current year or prior year loss; opinion qualified in either the current year or previous year; profit; leverage, inventory and account receivables, number of subsidiaries, extra-ordinary item/Net income presence of audit committee and date of year end. The results of their analysis show that there is a significant and positive co-efficient for the non-audit variable. Also size, Big 4, profit and none of subsidiaries are statistically significant showing a positive association with audit fees.

3. METHODOLOGY.
In this section we discuss variables we expect to affect audit fees. We draw on the methodological framework of De Fuentes Pucheta and Maria(2009) to identify factors that may affect and determine audit fees in Nigeria. Our sample consists of twenty two firms drawn across eleven classifications of sectors for firms quoted on the Nigerian stock Exchange through a stratified random sampling.

The general model specification for the factors affecting and determining audit fees in Nigeria are specified in a multiple regression equation thus:

\[
\text{nlogAF} = a_0 + a_1\text{SIZE} + a_2\text{BIG4} + a_3\text{LOSS} + a_4\text{OPINQUAL} + a_5\text{NPM} + a_6\text{LEV} + a_7\text{INVREC} + a_8\text{LIQ} + \mu
\]

Where:
LNAF = Natural log of audit fees (in thousands of Naira)
SIZE = Natural log of total sales or turnover (in thousands of Naira)
BIG4 = An indicator variable equal to 1 when the auditor is a Big Four firm, and 0 otherwise.
LOSS = An indicator variable equal to 1 if the firms report negative net income in the current year or in the prior two years, and 0 otherwise.
OPINQUAL = An indicator variable equal to 1 if the company received a qualified opinion in either the current or previous year, and 0 otherwise.
PROFIT = (NPM) Variable defined as net income less extraordinary items divided by total sales or turnover. LEV = Leverage (Total Debt/Total Asset). INVREC = Inventory plus accounts receivable divided by total assets.

3.1. The Dependent Variable, AUDIT FEE.
The fee dependence may influence the auditor to agree, against his/her better judgment, with management’s interpretations of accounting matters, which is an unethical behaviour that threatens auditor independence. The provision of audit services by an audit firm and the fact that it may jeopardize the independence of the auditor when issuing the audit report has repeatedly been a controversial issue. Therefore, after the well-known financial scandals surrounding the world, and with the aim of restoring the apparent independence of the auditors and the reliability of financial information, regulators have placed particular attention on the provision of audit services and it’s determinants. Literature has traditionally contemplated two aspects of the audit independence: the mental attitude of the auditor characterized by the integrity and the objective approach to the audit process (named in fact independence). Some authors (Bazerman, 2007; Moizer, 1997; Sutton, 1997 in De Fuentes Pucheta and Maria, 2009) point out that mental independence requires a freedom from personal interest, bias or
susceptibility to excessive pressure. However, since this mental process is unobservable and auditors also have incentives to violate their independence through satisfying their clients so as to maintain the economic bonding to the client (Bazerman, Moore, Tetlock & Tanlu, 2006; DeAngelo, 1981 in De Fuentes Pucheta and Maria, 2009), there is a need for the auditors to be perceived as independent (named independence in appearance) from the management team who prepares the financial statements.

In this regard, capital market regulators, owners and investors rely on the apparent independence of the auditor when establishing and considering a financial report.

3.2. Discussion of the Independent Variables

SIZE.
The most consistent result in all of the previous studies has been that company size is by far the most significant explanatory variable in determining audit fees. Then, the control variable measuring the natural log of total sales, SIZE, is intended to control for the size of the firm. It is probable that audit work will increase with company size and, consequently, it is expected that bigger clients will pay higher audit fees than smaller clients (Whisenant et al., 2003). Thus, the variable SIZE is hypothesised to have a positive relationship with audit fees. Thus SIZE was controlled by the natural log of turnover/total sales.

BIG4.
Meanwhile, evidence shows that auditor size (Cameran, 2005; Palmrose, 1986a) is one of the variables that explains the level of audit fees. According to several authors (Chan et al., 1993; Firth, 1985; Pong and Whittington, 1994), this is because the large accounting firms spend a lot of time and effort on testing and analysing information and data. In addition, according to DeAngelo (1981), big accounting firms can charge a premium as high quality auditors. Thus, a positive coefficient sign is expected on the BIG4 variable. The BIG4 is an indicator variable equal to 1 when the auditor is a Big Four firm (DT = Deloitte & Touche; PWC = PriceWaterhouseCoopers; EY = Ernst & Young; KPMG) and 0 otherwise (OAF = Other audit firms or Second tier firms) (Cristina and María Consuelo, 2009).

AUDIT RISK.
To capture audit risk (see, for instance, Chan et al., 1993; Firth, 1985), we include a variable reflecting whether the company reported negative net income/profit after tax in the current year or in the two prior years (LOSS). We expect a positive association between negative net income and audit fees.

OPINION QUALIFICATION.
Another variable in the audit fee equation to control for audit risk is whether the firms received a qualified audit report (OPINQUAL). Given that a qualified audit report is a measure of risk, we predict a positive relationship between audit fees and a qualified opinion. Audit Opinion = Nature of audit report (NAR). This variable takes the value 1 if the firm has received a qualified audit report and 0 if it has received a clean opinion (Cristina and María Consuelo, 2009).

NET PROFIT MARGIN.
A further audit risk variable is profit (PROFIT). Profitability can be another measure of firm risk and therefore, we expect high profitability to lower risk for the auditor, because it is supposed that the company will be in good financial health (Cristina and María Consuelo, 2009).

Moreover, we have also added PROFIT as a measure of performance (net profit margin), expecting a negative sign for the variable because a company with high profitability is supposed to be in good financial health, and less likely to receive a qualified audit report. NPM, net profit margin is captured by

\[
\text{Net Profit} = \text{Profit after tax} \times \frac{\text{Turnover/total sales}}{\text{Total Asset}} \tag{2}
\]

LEVERAGE.
To control for agency costs, we include leverage (LEV). A positive relationship between leverage and audit fees is expected. Leverage is calculated as

\[
\text{Total Debt} \div \text{Total Asset} \tag{3}
\]
LEVEL OF INVENTORY AND ACCOUNTS.
A high ratio of inventory plus accounts receivable divided by total assets (INVREC) shows that the company has high levels of accounts receivable and inventory and, as a result, a greater audit effort will be required. For this reason, we predict a positive association between INVREC and audit fees (Cristina and María Consuelo, 2009).

Thus calculated as Inventory + Accounts Receivable …………………………..(4)
Total Asset

FINANCIAL HEALTH.
Given that financial health has been identified as a factor that may increase the likelihood of the auditor(s) issuing a qualified report and thus unethical behavior may arise on the part of the auditor by the firm pressuring the auditor with higher fees for financial report smoothening.

LIQUIDITY = Ratio of current assets

\[
\text{LIQUIDITY} = \frac{\text{current assets}}{\text{current liabilities}}
\]

Table 1. Apriori Expectation for Coefficients
The following are a summary of the expected signs of the coefficients:

<table>
<thead>
<tr>
<th>Variable</th>
<th>Apriori Expectation</th>
</tr>
</thead>
<tbody>
<tr>
<td>SIZE</td>
<td>+ive</td>
</tr>
<tr>
<td>BIG4 Auditor</td>
<td>+ive</td>
</tr>
<tr>
<td>LOSS</td>
<td>+ive</td>
</tr>
<tr>
<td>OPINQUAL</td>
<td>+ive</td>
</tr>
<tr>
<td>High Profit</td>
<td>-ive</td>
</tr>
<tr>
<td>High LEV</td>
<td>+ive</td>
</tr>
<tr>
<td>High liquidity</td>
<td>-ive</td>
</tr>
<tr>
<td>INVACCREC</td>
<td>+ive</td>
</tr>
</tbody>
</table>

Source: Author’s Compilation.

4. FINDINGS.
In this section, we present the result of the OLS in the table below.

Table 2. OLS Result.

<table>
<thead>
<tr>
<th>Dependent Variable: NLOGAF</th>
</tr>
</thead>
<tbody>
<tr>
<td>Method: Least Squares</td>
</tr>
<tr>
<td>Date: 03/20/13  Time: 17:18</td>
</tr>
</tbody>
</table>

<table>
<thead>
<tr>
<th>Variable</th>
<th>Coefficient</th>
<th>Std. Error</th>
<th>t-Statistic</th>
<th>Prob.</th>
</tr>
</thead>
<tbody>
<tr>
<td>SIZE</td>
<td>-1.119614</td>
<td>0.340883</td>
<td>-3.284455</td>
<td>**0.0020</td>
</tr>
<tr>
<td>PROFIT</td>
<td>-0.052191</td>
<td>0.073339</td>
<td>-0.711640</td>
<td>0.4804</td>
</tr>
<tr>
<td>LIQ</td>
<td>-0.035696</td>
<td>0.015973</td>
<td>-2.234753</td>
<td>**0.0306</td>
</tr>
<tr>
<td>LEV</td>
<td>0.083148</td>
<td>0.049523</td>
<td>1.678995</td>
<td>0.1002</td>
</tr>
<tr>
<td>INVACCREC</td>
<td>0.007579</td>
<td>0.020069</td>
<td>0.377622</td>
<td>0.7075</td>
</tr>
<tr>
<td>OPINQUAL</td>
<td>-0.162634</td>
<td>0.256240</td>
<td>-0.634694</td>
<td>0.5289</td>
</tr>
<tr>
<td>BIGFOUR</td>
<td>0.152420</td>
<td>0.041242</td>
<td>3.695756</td>
<td>**0.0006</td>
</tr>
<tr>
<td>LOSS</td>
<td>-0.133312</td>
<td>0.065808</td>
<td>-2.025771</td>
<td>**0.0489</td>
</tr>
<tr>
<td>C</td>
<td>1.442744</td>
<td>0.289925</td>
<td>4.976258</td>
<td>0.0000</td>
</tr>
<tr>
<td>R-squared</td>
<td>0.539303</td>
<td>Mean dependent var</td>
<td>0.579747</td>
<td></td>
</tr>
<tr>
<td>Adjusted R-squared</td>
<td>0.455540</td>
<td>S.D. dependent var</td>
<td>0.125013</td>
<td></td>
</tr>
<tr>
<td>S.E. of regression</td>
<td>0.092244</td>
<td>Akaike info criterion</td>
<td>-1.775236</td>
<td></td>
</tr>
<tr>
<td>Sum squared resid</td>
<td>0.374395</td>
<td>Schwarz criterion</td>
<td>-1.440658</td>
<td></td>
</tr>
<tr>
<td>Log likelihood</td>
<td>56.04375</td>
<td>F-statistic</td>
<td>6.438424</td>
<td></td>
</tr>
<tr>
<td>Durbin-Watson stat</td>
<td>1.445156</td>
<td>Prob(F-statistic)</td>
<td>0.000016</td>
<td></td>
</tr>
</tbody>
</table>
Source; Authors’ Eviews Output. ** Significant at 5% confidence level.

Our R$^2$ the coefficient of multiple determination of .539 indicates that 53.9% of the variations in our dependent variable are explained by our independent variables. The comparison of our expected signs and actual signs are presented in table three below.

Table 3. Comparison of Apriori Expectation and Actual Result.

<table>
<thead>
<tr>
<th>Variable</th>
<th>Apriori Expectation</th>
<th>Actual Result</th>
</tr>
</thead>
<tbody>
<tr>
<td>SIZE</td>
<td>+ive</td>
<td>-ive</td>
</tr>
<tr>
<td>BIG4 Auditor</td>
<td>+ive</td>
<td>+ive **</td>
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<td>-ive **</td>
</tr>
<tr>
<td>INVACCREC</td>
<td>+ive</td>
<td>+ive **</td>
</tr>
</tbody>
</table>

Source; Authors’ Compilation.

The major revelations of our study is that the size of the firm as measured by the natural log of turnover or total sales although negative but significantly affects auditors remuneration in Nigeria. This revelation challenges the findings of Alain (2000); Joshi, and Bastaki (2000); De Fuentes Pucheta and Maria, (2009) concerning the positive relationship between audit fees and the size of the firm. The implication of this result is that the size of the firm negatively determines the fees charged by independent auditors in Nigeria.

However, our regression equation shows that the signs of the auditor type (BIG4), profitability, leverage, liquidity and the ratio of inventory plus accounts receivable are in consonance with apriori expectations and studies of Mohd (2005); De Fuentes Pucheta and Maria, (2009); Dinh (2012); Ming-Wei and Steven (1996). Therefore, the auditor characteristics, profitability, leverage, liquidity are the major determinants of independent auditors remunerations in Nigeria.

5. CONCLUSION

External users of financial statements have to rely on the trust reposed on the independent auditor’s expressed in an opinion on financial statements to make investment decisions and hence the importance of independent auditors in financial reporting. Nevertheless, this trust might be broken unethically and thus raises the questions of what determines independent auditors’ remuneration in Nigeria. Our model drawn from past studies included variables such as size of the firm, the characteristics of the auditor, profit, ratio of inventory plus accounts receivable divided by total assets to evaluate the determinants of auditors’ remuneration in Nigeria. Our multiple regressions result confirms that auditor type (BIG4), profitability, leverage, liquidity and the ratio of inventory plus accounts receivable are the determinants of auditors’ remuneration in Nigeria.

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