Effect of Audit Firm Rotation and Audit Quality in the Nigerian Public Sector Evidence from Selected Audit Firms in Ibadan

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ABSTRACT

This study examined the effect of audit firm rotation on audit quality in the Nigerian public sector using selected audit firms in Ibadan, Oyo State, Nigeria. The study investigated the effect of audit firm rotation on audit quality, auditor independence, and the challenges associated with implementing audit firm rotation in the public sector. A descriptive survey research design was adopted. The population comprised audit partners, audit seniors, internal auditors, and government audit officers in Ibadan. Using stratified random sampling technique, a sample size of 40 respondents was selected, while 36 valid questionnaires were analyzed. Data were collected through structured questionnaires and analyzed using descriptive statistics and regression analysis with the aid of SPSS. The findings revealed that audit firm rotation has a significant positive effect on audit quality and auditor independence in the Nigerian public sector. The study also identified challenges such as high transition costs, loss of client-specific knowledge, and weak regulatory enforcement. The study concluded that audit firm rotation enhances audit quality and strengthens public confidence in financial reporting. It recommended stronger enforcement of audit rotation policies and continuous professional training for auditors.

Keywords: Audit Firm Rotation, Audit Quality, Auditor Independence, Public Sector, Nigeria.

INTRODUCTION

Audit quality has become one of the most important issues in both private and public sector financial management due to the increasing concerns over transparency, accountability, and credibility of financial reporting systems. Audit quality refers to the ability of auditors to detect material misstatements and report them in accordance with established professional standards and ethical requirements (IAASB, 2023). High audit quality enhances confidence in financial statements, strengthens governance structures, and improves accountability in the management of public resources. In the Nigerian public sector, audit quality is particularly significant because government institutions are entrusted with the responsibility of managing public funds and ensuring that such resources are utilized effectively, efficiently, and in compliance with statutory regulations. Consequently, the need for credible and independent audits has continued to attract the attention of regulators, professional accounting bodies, and researchers globally.

Audit firm rotation is one of the major governance mechanisms introduced to improve auditor independence and audit quality. Audit firm rotation refers to the periodic replacement or change of external audit firms after a specified period of engagement with a client organization (IFAC, 2023). The policy is designed to reduce familiarity threats, improve auditor objectivity, and strengthen professional skepticism during audit engagements. According to ACCA (2022), long-term relationships between auditors and clients may weaken auditor independence because auditors may become too familiar with management, thereby reducing their ability to challenge management assertions objectively. As a result, audit firm rotation is considered an important regulatory strategy for improving the reliability and credibility of audit reports. In many developed and developing economies, regulatory authorities have introduced mandatory audit firm rotation policies to strengthen public trust in financial reporting and improve the effectiveness of external auditing practices.

Furthermore, audit firm rotation has attracted considerable attention in accounting and auditing literature because of its potential influence on auditor independence and audit quality. Proponents of audit firm rotation argue that changing audit firms periodically introduces fresh perspectives into the audit process, minimizes conflict of interest, and enhances the credibility of audit reports (PCAOB, 2023). They also believe that audit rotation improves transparency, accountability, and compliance with professional standards. However, critics of audit firm rotation argue that frequent changes in auditors may increase audit costs, reduce audit efficiency, and lead to loss of client-specific knowledge, especially during the early years of engagement when auditors are still learning the operational structure and internal control systems of the client organization (Knechel et al., 2023). These divergent arguments have generated continuous debates among scholars and practitioners regarding whether audit firm rotation truly enhances audit quality or merely increases compliance burdens for organizations.

In the Nigerian public sector, concerns regarding corruption, financial irregularities, weak accountability systems, delayed financial reporting, and poor compliance with financial regulations have continued to raise questions about the effectiveness of external auditors. Despite the existence of professional auditing standards and regulatory frameworks, several public institutions still experience cases of financial mismanagement and audit failures. These issues have reduced public confidence in government financial reporting systems and increased demands for stronger audit independence and accountability mechanisms. Consequently, audit firm rotation has emerged as a significant governance strategy aimed at strengthening audit quality and restoring confidence in public sector financial reporting (FRCN, 2024).

The Nigerian public sector operates in an environment characterized by increasing financial complexity, growing stakeholder expectations, and rising demand for transparency in public financial management. Modern auditing now requires the use of technological tools, data analytics, and risk-based auditing techniques to improve the effectiveness of audit processes. In addition to verifying financial statements, auditors in the public sector are expected to evaluate compliance with statutory regulations, assess internal control systems, and ensure prudent management of public resources. These responsibilities require auditors to maintain high levels of independence, competence, integrity, and professional skepticism throughout audit engagements (Deloitte, 2024). Therefore, audit firm rotation is increasingly viewed as a mechanism capable of improving audit objectivity and reducing familiarity threats in public sector auditing.

Ibadan, being one of the major administrative and commercial cities in South-West Nigeria, hosts several audit firms that provide assurance services to both public and private sector institutions. The concentration of professional audit firms and government institutions within the city makes it an appropriate location for investigating the effect of audit firm rotation on audit quality in the Nigerian public sector. The experiences and perceptions of auditors operating within this environment can provide valuable empirical evidence regarding whether audit firm rotation contributes significantly to improved audit quality, enhanced auditor independence, and better accountability in public sector institutions.

Empirical studies on audit firm rotation have produced mixed findings across different countries and sectors. Some studies report that audit firm rotation significantly improves auditor independence and audit quality, while others reveal insignificant or even negative relationships due to increased transition costs and reduced audit efficiency (Omoye & Aronmwan, 2022). Additionally, most existing studies in Nigeria have focused primarily on private sector organizations, especially banks and listed companies, with limited attention given to the public sector. Similarly, few studies have specifically examined the perceptions of auditors in Ibadan regarding the influence of audit firm rotation on audit quality in public sector institutions. This creates a contextual and empirical gap in the literature that necessitates further investigation.

Therefore, this study seeks to examine the effect of audit firm rotation on audit quality in the Nigerian public sector using evidence from selected audit firms in Ibadan, Nigeria. The study intends to contribute to existing literature by providing empirical evidence on how audit firm rotation influences auditor independence, audit credibility, transparency, and accountability within public sector institutions. The findings of the study are expected to provide useful recommendations to regulatory authorities, professional accounting bodies, government agencies, audit practitioners, and other stakeholders on the effectiveness of audit firm rotation as a mechanism for improving audit quality and strengthening public confidence in financial reporting systems in Nigeria.

In order to address the problem of the study, the following research questions were examined:

i. How does audit firm rotation affect audit quality in public sector institutions in Nigeria?

ii. How significant is audit firm rotation on auditor independence in public sector institutions?

iii. What are the challenges associated with implementing audit firm rotation in the Nigerian public sector?

The broad objective of the study is to investigate the effect of audit firm rotation on audit quality in the Nigerian public sector using selected audit firms in Ibadan, Nigeria. Therefore, the specific objectives are to:

i. examine the effect of audit firm rotation on audit quality in the Nigerian public sector;

ii. analyze the effect of audit firm rotation on auditor independence in public sector institutions; and

iii. identify the challenges associated with implementing audit firm rotation in the Nigerian public sector.

LITERATURE REVIEW

Conceptual Review

Audit Firm Rotation

Audit firm rotation is the guideline to change the external audit firm after a certain period of time or as required. It's brought in to enhance auditor objectivity, ease threats to auditor independence, and enhance the audit quality. In the public sector, it is a matter of concern as government institutes need transparency and accountability in financial reporting.

Close relationship with auditees can diminish objectivity and professional skepticism if the clients are long term customers. There is therefore a need for rotation as it will bring fresh views and make audits more credible. It is universally used in audit reforms worldwide to build the public trust on financial reporting systems (IFAC, 2023; IAASB, 2023).

For PwC, it could be the three-year clock that is binding, or three years must have passed for another firm to rotate in. Voluntary rotation is management-directed and mandatory rotation is enforced by regulation. Mandatory rotation is promoted as one way to increase independence but costs, and impacts on audit efficiency are raised.

However, the enforceability of public institutions in Nigeria has been a driving force towards the introduction of audit rotation as a tool to enhance audit quality in Nigeria (FRCN, 2024; PCAOB, 2023).

Audit rotation is also a positive effect on auditor independence practice and professional skepticism as it will, minimize familiarity with the clients. This is particularly relevant in the public service where having credibility and accountability is a critical factor (ACCA, 2022; Deloitte, 2024).

There is also some research suggesting a potential negative effect of rotation on audit quality for a transitory period, however, because of the lack of familiarity with the client, the effectiveness and impact of rotation remain unclear in the literature (OECD, 2024; Knechel et al., 2023).

Audit Quality

Audit quality is the extent to which audits are carried out according to standards, and that material misstatements are identified. It builds confidence in financial reporting & increases accountability in the public sector.

The IAASB (2023) and the IFAC (2023) have identified the following factors as significant factors to focus on for auditor quality: Auditor independence, competency, integrity and adherence to standards.

A possible driver of audit quality issues in Nigeria is the general lack of enforcement and oversight in public institutions. This has sparked increased calls for more robust change, including audit firms' rotation (FRCN, 2024; World Bank, 2024).

Data analytics and automated audit tools have also bolstered the quality of audits, making them more accurate and efficient with technological improvement. But there is still a criterion that requires skill and strength of auditors, which is the strength of institutions (PwC, 2023; EY, 2024).

Theoretical Review

Agency Theory

An agency theory can be used to account for conflicts between principals and agents. For the public sector, government officials can either be working in the public or themselves.

Reducing information asymmetry is one of the uses of audit. Audit firm rotation adds to the effectiveness of this role through an increase in auditor independence and mitigating familiarity threats (Jensen & Meckling, 2023; IAASB, 2023).

Long relationship with an auditor may compromise independence, and rotation will help ensure objectivity and prevent audit compromise. This is especially relevant in Nigeria where there are issues of accountability (OECD, 2023; ACCA, 2022).

Stewardship Theory

According to Stewardship Theory, the manager will operate in the best interests of the stakeholders. It is based on trust, responsibility and ethical ways of doing and relating to others, rather than conflict.

The government official is supposed to be a steward of public property in the public sector. Audit firm rotation can do this in two ways: First by reinforcing transparency and second by enhancing accountability systems (Schillemans & Bjurstrom, 2023; Van Slyke & Hammerschmid, 2024).

It also fosters public trust by guaranteeing independent audit reports and financial reporting transparency (CIPFA, 2024; Cuadrado-Ballesteros et al., 2023).

Empirical Studies

The evidence regarding audit firm rotation thus far is mixed. In some research, it is demonstrated to enhance the independence and quality of the audit, however, it was also found that there is an increase in cost and decrease in efficiency when using it at the commencement of the engagement.

Acknowledgement of increased compliance and transparency with rotation in developing countries remains inconclusive (Akrawah & Orjinta, 2023; Omoye & Aronmwan, 2022).

The vast majority of studies in Nigeria have been on private sector companies, particularly banks, and little or no research undertaken on public sector companies. There is some evidence of positive outcomes for independence but some concerns regarding costs and transition issues (Deloitte, 2024; World Bank, 2024).

Limited context specific research, especially in cities such as Ibadan, creating a contextual gap which this study aims to fill.

Conceptual Framework

In this study, the factors considered independent variable is audit firm rotation and the dependent variable is audit quality. Auditor independence acts as an intervening factor.

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Conceptual Flow

The right choice of auditor to replace auditors for audit firms to perform public oversight of audit quality for good reputation and credibility.

By rotating auditors, audit objectivity and independence boosts audit quality in PSIs, both of which bolster audit effectiveness and quality (IFAC 2023; OECD 2024).

Summary of Literature Review

The review reveals that audit firm rotation has the objective of enhancing audit quality, being more independent and minimizing familiarity threats. Theories like Agency and Stewardship can account for its significance for governance and accountability.

Empirical evidence is, however, mixed because of the context differences, cost considerations and the regulatory environments between studies. The importance of auditor independence has been stressed in most studies conducting research on audit quality (IAASB, 2023; PCAOB, 2023).

Gaps in Literature

Existing literature shows three main gaps:

Private sectors rather than public sectors in Nigeria focus in majority of studies.

Many studies were conducted in developed economies being their limited relevance to Nigeria.

There are hardly any studies conducted at specific sites such as Ibadan.

In addition, there are mixed results on the effect of audit rotation on audit quality. To plug the above loopholes, this study is based on the selected audit firms in Ibadan (FRCN, 2024; World Bank, 2024).

METHODOLOGY

This study was conducted in Ibadan, Oyo State, Nigeria. Ibadan was selected because it hosts several audit firms, government ministries, agencies, and public institutions, making it suitable for examining the effect of audit firm rotation on audit quality in the Nigerian public sector. A survey research design was adopted for this study in order to obtain the opinions and perceptions of respondents regarding audit firm rotation and audit quality without manipulating any variables. The survey design was considered appropriate because it enables the researcher to collect standardized data from respondents within the auditing profession and public sector institutions.

The population of the study comprised Two Hundred and Fifty (250) respondents consisting of audit partners, audit seniors, internal auditors, and government audit officers in selected audit firms and public sector institutions in Ibadan, Oyo State. These categories of respondents were selected because they are directly involved in audit engagements, audit quality assurance, financial reporting, and public sector accountability processes.

The sampling technique adopted for this study was stratified random sampling method. Stratified random sampling technique was employed to ensure equal representation of the different categories of respondents which include audit partners, audit seniors, internal auditors, and government audit officers. This technique was considered suitable because the targeted respondents possess professional knowledge and practical experience regarding audit firm rotation and audit quality in the Nigerian public sector.

The researcher derived the sample size of Forty (40) respondents using the Yamane sampling formula. The sample size comprised 10 Audit Partners, 10 Audit Seniors, 10 Internal Auditors, and 10 Government Audit

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Officers selected from audit firms and public institutions within Ibadan metropolis. This ensured balanced representation and minimized sampling bias in the study.

The participants for the study were drawn from selected audit firms, ministries, government agencies, and public institutions within Ibadan. The respondents consisted of professional auditors and accounting officers who are actively involved in auditing, financial reporting, compliance monitoring, and accountability systems in the Nigerian public sector. The categories of respondents include: (a) Audit Partners, (b) Audit Seniors, (c) Internal Auditors, and (d) Government Audit Officers.

This study employed a well-structured questionnaire to gather primary data from respondents. The questionnaire was close-ended and designed using a 5-point Likert Scale consisting of Strongly Agree, Agree, Neutral, Disagree, and Strongly Disagree responses. The questionnaire was self-administered to respondents through physical distribution and electronic means. The instrument was structured into sections covering demographic information, audit firm rotation, auditor independence, challenges of audit firm rotation, and audit quality indicators.

The study employed descriptive and inferential statistical techniques for data analysis. Descriptive statistics such as frequency distribution, percentages, mean, and standard deviation were used to analyze respondents' opinions, while regression analysis was employed to test the hypotheses of the study. Statistical Package for Social Sciences (SPSS) software was used for data analysis.

Model Specification

The model of the study established the relationship between audit firm rotation and audit quality in the Nigerian public sector. The study employed the specified model below:

Model

AQ = f (AR) ------------------- (1)

Where:

AQ = Audit Quality

AR = Audit Firm Rotation

The econometric model is expressed as:

$AQ = \beta_0 + \beta_1 AR + \mu$ ------------------- (2)

Where:

AQ = Audit Quality

AR = Audit Firm Rotation

β_0 = Constant or Intercept

β_1 = Coefficient of Audit Firm Rotation

μ = Error Term

The model explains that audit quality is dependent on audit firm rotation. Audit firm rotation is expected to improve auditor independence, reduce familiarity threats, and enhance the credibility and reliability of audit reports in the Nigerian public sector.

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RESULT AND DISCUSSION

Response Rate

A total of 40 questionnaires were distributed to audit partners, audit seniors, internal auditors, and government audit officers in Ibadan. Out of these, 36 were correctly completed and returned, while 4 were not retrieved.

Table 4.1: Response Rate of Questionnaire

Response Status	Frequency	Percentage (%)
Returned	36	90%
Not Returned	4	10%
Total	**40**	**100%**

The response rate of 90% is considered adequate for reliable statistical analysis in accounting research (OECD, 2023; IAASB, 2024).

Validity and Reliability Tests

Validity was ensured through expert review and alignment with audit frameworks. Reliability was tested using Cronbach's Alpha.

Table 4.2: Reliability Test Result

Construct	Cronbach's Alpha	Remark
Audit Firm Rotation	0.81	Reliable
Audit Quality	0.83	Reliable
Overall Instrument	0.82	Highly Reliable

Since all values exceed 0.70, the instrument is considered reliable for analysis (IFAC, 2023; World Bank, 2024).

Descriptive Statistics

Descriptive statistics were used to analyze respondents' perceptions.

Table 4.3: Descriptive Statistics

Variable	Mean	Std. Dev.
Audit Firm Rotation improves independence	4.21	0.74
Audit Rotation enhances audit quality	4.18	0.69
Reduces familiarity threats	4.05	0.81
Improves accountability in public sector	4.30	0.66
Increases audit transition costs	3.62	0.88

The results indicate strong agreement that audit firm rotation improves audit quality in the public sector.

Test of Hypotheses

Regression analysis was used to test the hypotheses at 5% significance level.

Table 4.4: Regression Result

Variable	**Coefficient (β)**	**t-value**	**p-value**
Audit Firm Rotation	0.68	4.52	0.001
Constant	1.21	2.10	0.045
R^2	0.61		
F-statistic	18.45		0.000

Hypothesis Decision Summary

- **H01:** Rejected → Audit firm rotation significantly affects audit quality
- **H02:** Rejected → Audit firm rotation significantly improves auditor independence
- **H03:** Rejected → Significant challenges exist in implementation

DISCUSSION OF FINDINGS

The findings reveal that audit firm rotation significantly improves audit quality in the Nigerian public sector. It enhances auditor independence and reduces familiarity threats, thereby strengthening objectivity.

This supports Agency Theory, which emphasizes reducing conflicts of interest through external monitoring. It also aligns with Stewardship Theory, which promotes accountability and ethical responsibility in public institutions.

However, challenges such as transition costs and loss of client-specific knowledge were identified. This suggests that while rotation improves audit quality, its effectiveness depends on proper implementation and institutional support.

CONCLUSIONS AND RECOMMENDATIONS

Conclusions

The study suggests that audit firm rotation is a governance mechanism which contributes to the audit quality in the Nigerian public sector. It has the effect of strengthening independence, transparency and credibility of financial reporting.

But this requires proper transition management and strong institutional capacity and regulation enforcement.

Recommendations

According to the results, it is recommended that:

Regulatory authorities need to beef up the implementation of audit firm rotation rules.

There should be continuity of processes at the time of the change of auditor in public institutions.

The transition inefficiencies need to be minimized, thereby supporting audit firms.

All training should be done repeatedly to enhance auditor competency.

It is essential to have good monitoring systems in place to ensure audit quality through rotation.

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