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FIRM ATTRIBUTES AND AUDITOR SELECTION CHOICE IN QUOTED MANUFACTURING COMPANIES IN NIGERIA

IHIMEKPEN Aigbe Friday[1] JOSIAH, Mary[2], and OHONBA, O .Ernest[3]

Accounting Department, Federal Polytechnic Auchi[1]
Accounting Department, Igbinedion University Okada, College of Management and Business Studies[2]
Accounting Department, School Business Studies, Edo State Polytechnic, Usen[3]
majoel2003@yahoo.com
08037381270/08051104541

ABSTRACT

This study focuses on firm attributes and auditor choice by manufacturing companies focusing on a mixture of both audit firm factors such as the audit fee and then the audit client factors such as complexity and corporate governance. The longitudinal research design is used in this study. The population of the study covers all manufacturing companies quoted on the Nigerian stock exchange as at the study period. The simple random sampling technique was employed in selecting the 30 manufacturing companies for 2010-2018 financial years. Secondary data was used for the study. The secondary data will be retrieved from financial statements of the sampled companies for 2010 - 2018 financial years. In this study, the descriptive statistical methods will include numerical techniques such as the means, standard deviation, range, frequency distribution. More importantly, the binary regression was used in those model estimations and in the determination of the causal relationship between the variables. Using the binary regression technique, the study found that the audit fees and firm complexity has significant influence over the likelihood that a firm selects a particular type of auditor. The study recommends that there may be need for regulation of audit pricing so as not to take the big 4 auditors above the reach of most firms. Again audit clients must efficiently look at the cost and benefits analysis before selecting a particular audit firm. Secondly, the study recommends that companies must also ensure that complexity comes with increases in revenue generated to sustain the choice of the big 4 for those firms that prefer that option. Finally, the study recommends that audit quality and audit service delivery of all audit firms whether big 4 or non-big 4 should be of the highest quality possible

Key Words: Firm complexity, corporate governance, audit fees and auditor choice

INTRODUCTION

One of the corporate governance mechanisms available to companies, mentioned by Broye and Weill (2008) is the hiring of auditors. Having the option to choose from a wide range of audit firms, and because company managers experience several incentives whether or not to choose a particular auditor, this decision has been the subject of many previous studies. However, the debate concerning the factors influencing this company managers' decision is still ongoing. The main reason proposed in the literature for a company to hire an auditor and to accept the additional monitoring by an external party, is derived from the agency theory. Company managers make this decision with the intention to reduce agency costs caused by several information asymmetries arising in a company's environment.

DeAngelo (1981) suggested that as the agency costs of a firm may vary, for example into time, the need for a certain quality level of the external monitoring might also change.

In retrospect, to make predictions about the choice of an auditor based on auditor-client compatibility requires two conditions: (i) variation in client preferences regarding the audit and auditor and (ii) variation across auditors in their ability to satisfy those preferences. If auditors are all essentially equivalent (no auditor variation), clients could randomly choose between them. On the other hand, if auditors vary but clients all have the same preferences, then all the clients would prefer the same auditor subject to capacity constraints.. Hence the focus of this study is to examine firm attributes and auditor choice for manufacturing companies in Nigeria. Particularly, we narrow our focus to three important variables; Firm complexity, board independence, board size which are corporate governance variables and Audit fees.

Statement of the Problem

In searching the literature on firm attributes and auditor choice, what can be easily observed is that there are several reasons put forward to explain why company managers choose a particular auditor and the empirical evidence has been far from unanimous. For example, according to Johnson and Lys (2009), client's operating, investing, and financing activities was pointed out to be the most crucial factor but this is not the opinion of Adams and Davis (2004) which found that disagreement about content of financial reports is the major factor. Disagreement about auditor opinion is an important factor as argued by Haskins and William, (2009). Differing from all the views above, Chow and Rice, (2008) indicated that change of management and auditor fees are the key issues to be considered. Ismail and Aileahmed (2008) argued in support of size of the audit firm, tenure of auditor, audit firm reputation, dissatisfaction with services provided by current auditors; change in corporate management and audit fees. This view was also supported by Chow and Rice, (2008)

The gap that we observed is that most of the studies did not make mention of firm complexity and corporate governance though audit fee issues have been examined more. Hence the study will throw light on the role of firm complexity board independence and board size not leaving out audit fees. Another gap that was observed is that despite the critical nature of this issue, in the Nigerian environment, the issue of auditor selection for manufacturing companies have been scarcely examined. Aside from the recent study Olowokere and Janis (2016) using manufacturing sector but used primary data which may be highly subjective and prone to respondent bias, the researcher is unaware of any other study that has explored this issue.

Research Hypothesis

The research hypotheses are as follows;

H_{O1}. Firm complexity has no significant influence on Auditor choice of manufacturing companies.

H_{02}. Board Independence has no significant influence on Auditor choice of manufacturing companies.

H_{03}. Board Size has no significant influence on Auditor choice of manufacturing companies.

$H_{04:}$ Audit fees have no significant influence on Auditor choice of manufacturing companies.

LITERATURE REVIEW

Auditor Choice

The annual financial information are vital tool prepared and used by managers of the firm to

communicate financial report to investors and stakeholders, while concurrently decreasing the level of information asymmetry that exists among owners and managers (Antle & Nalebuff, 2016) Thus, the financial statements should be read as a joint statement from management and the auditor (Antle & Nalebuff, 2016). Audit quality is improved if material misstatements are detected and reported (or corrected). A failure to detect or give information on material misstatement or errors in the financial information before issuing an unqualified audit report impairs audit quality. In current years a numeral of threats to audit quality have been known. This includes the concern that close relatives among the auditor and the client weaken auditor independence and this lead to the recommendation of auditor rotation.

Firm Complexity

Complexity of the auditee can be précised by many branches and subsidiaries of the firm locally and globally. It is argued that the extra complex the client firm has, the larger the number and the more diversified the subsidiaries and operations which require more audit work; therefore, audit firms charge higher audit fees. Sandra and Patrick (1996) showed that auditors of very complex firms are often the big 4 auditors and they charge high audit cost in investigative and evaluating the firm's financial information. According to them, overseas subsidiaries have to stand by a variety of legislative and capable needs for disclosure, which necessitates additional audit testing, requiring extra time and additional manpower to finished the audit process. This means that the companies have to permit additional charges for audit work. as a result, auditee complexity has significant correlation with the auditor choice. (Carson Fargher, Simon & Taylor 2004). In a very small company, the owner (manager) can control the operations by direct supervision. However, as a company grows larger it becomes more complex and difficult to control.

Audit Fee

The external audit services and audit fees remunerated by companies to their auditors are perceptibly of interest to both companies and auditors. Companies are statutorily required to have their financial reporting audited and wish that the amount they pay be reasonable, auditors present such services and want to make sure that the fees they charge are enough to enable a acceptable service to be provided (Gist, 1992). More so, companies and auditors, the shareholders in particular and the community in general are anxious that the audit fee is not set of such a level, (it is either too high or too low) it might undermine confidence in the audit opinion. in addition, the level of audit fees and how they are determined are important matters to both national and global professional accounting bodies to point out the basis on which audit fees should be strong-minded, the costs which should be enclosed by an audit fee, and the factors which should be taken into account when considering the audit fee. In addition these statements were also planned to restrict auditors from charging their amount on a basis which might be unable to get along with the ethical values connected with the audit profession. as a result, they seek to defend the auditors from losing their objectivity, and efficiency as independent auditors. In universal, the external audit cost has four indispensable aspects: Determining the charge, business the charge, billing the fee and receiving the charge.

Board Size and Auditor Selection

With regards to the association between board size and auditor selection choice, Suryanto, Thalassinos and Thalassinos, (2017) examines the association between board size and the audit

quality. Data from non-financial companies listed in the Indonesian Stock Exchange have been used. The data of 121 listed companies in a five-year time from 2012 to 2016 is composed from the written audit accounts available on company's websites. The result of the study have reveal that in non-financial firms listed in the Indonesian Stock Exchange board size have most important result on auditor choice because of the need to ensure audit quality.

Board Independence and Auditor Selection

Adams and Ferreira (2007) explained in theory that more independence reduces the board's information making, hurts its advisory position, and may also reduce its monitoring purpose. If independent directors have stronger monitoring remuneration than dependent directors, the CEO responds to larger board independence by given that less information. In addition, the effectiveness of independent board members arguably depends on their competence. (Adams, 2012). Consequently, independent directors have a strong tendency to select auditors which they believe can help them in their monitoring role and that can improve corporate transparency.

Empirical Review

Abdulmalik and Che-Ahmad (2015) investigates the level which risk management committee and corporate governance committee forecast auditor choice in Nigeria. The authors used random panel data regression examination whether risk management committee and corporate governance committee influence audit fees. The authors obtained the data used for this study from the annual reports of public listed companies on the Nigerian Stock Exchange from 2008-2013. The results show a positive connection among organization of risk management committee and auditor choice while the organization of corporate governance committee has an immaterial relationship with auditor choice.

Olowokere and Inneh, (2016), investigates the determinants factors affecting auditors choice in quoted manufacturing companies in Nigeria. This study utilized both qualitative and quantitative data. The qualitative data were collected through the administration of prepared questionnaire, while the secondary data were sourced from annual accounts and information of sampled companies. The survey on the determinants of the choice of auditors used by Oxera, (2006) was adopted for the study. 500 copies of the questionnaire were shared among respondents who were purposively selected among shareholders of the quoted manufacturing companies in south western part of Nigeria. 308 copies of the questionnaire were returned and analyzed. The analysis revealed that response rate was 62%. Purposive sampling technique was adopted because it enables the researchers to identify and utilize knowledgeable shareholders in the process of selecting external auditors (include: members of audit committee, Managing Director, finance director and company secretary). Data collected were analyzed using both descriptive and inferential statistics. Logistic Regression Analysis method was used to analyze the data. The results showed that the two most important factors influencing the company's choice of auditors are international coverage and long-term relationship with current auditors. Collectively, the findings have important implications for audit markets in emerging economies in which the sustainability of manufacturing firms is crucial to overall economic development.

METHODOLOGY

Model Specification

The model of this study investigate the firm attributes and auditor choice selection in selected manufacturing companies. The model builds on that of Olowokere and Inneh, (2016) which investigated the determinants factors affecting auditor's choice in quoted manufacturing companies in Nigeria. The model for this particular study is given below.

$AUDCH_{it} = \partial_0 + \partial_1 COMP_{it} + \partial_2 BDIND_{it} + \partial_3 BDS_{it} + \partial_4 AUDF_{it} + \mu_{it}$ ---------- (1)

Where: AUDCH = Auditor choice, FCOMP= Firm complexity, BDIND= Board independence, BS= Board size , AUDF= Audit fee , u= error term

Whole:

AUDCH= Audit firm choice, AUDFEE= Audit fee, BSIZE= Board size, BDIND= Board independence, COMP= Complexity

DATA PRESENTATION AND ANALYSIS

Presentation of Result

Table 4.1: Descriptive Statistics

	AUDCH	AUDFEE	BSIZE	COMP	BDIND
Mean	0.535885	41573617	9.100478	4.698565	0.636837
Median	1.000000	11719306	9.000000	1.000000	0.625000
Maximum	1.000000	4.53E+08	17.00000	42.00000	1.000000
Minimum	0.000000	422741.0	4.000000	0.000000	0.333333
Std. Dev.	0.499908	68034458	2.704066	8.837205	0.156702
Skewness	-0.143912	2.923446	0.566046	2.925834	0.050794
Kurtosis	1.020711	13.07362	2.573434	11.59961	2.261163
Jarque-Bera	34.83707	1181.406	12.74544	942.2015	4.843573
Probability	0.000000	0.000000	0.001708	0.000000	0.018763
Observations	209	209	209	209	209

Source: Researchers compilation (2019)

The table above shows the descriptive statistics for the variables and as can be observed, AUDCH has a mean value of 0.535 which suggest that about 53.5% of the sample use the big 4 audit firms. The Jacque-bera statistics for data normality reveals that the series is normally distributed given the P-value of the J.B (p= 0.000). The mean for AUDFEE stood at 41573617(mn) with maximum and minimum values of 4.53e+08(mn) and 4227410(mn). The Jacque-bera statistics for data normality reveals that the series is normally distributed given the J.B value of 1181.406 (p= 0.000). The mean for board independence stood at 0.646 which suggest that on the average about 64% of the board members are independent directors with maximum and minimum values of 1 and 0.33 respectively. The Jacque-bera statistics for data normality reveals that the series is normally distributed given the J.B value of 4.8434 (p= 0.0187). The mean for board size stood at approximately 9 with maximum and minimum values of 17 and 4 respectively. The Jacque-bera statistics for data normality reveals that the series is normally distributed given the J.B value of 12.745 (p= 0.0017). The mean for complexity stood at approximately 5 which suggest that on the average most companies in the sample have about 5 branches with maximum of 42 and minimum of 0. The Jacque-bera statistics for data normality reveals that the series is normally distributed given the J.B value of 942.2015 (p= 0.000).

Table 4.2: Pearson Correlation Statistics

	AUDCH	AUDFEE	BSIZE	COMP	BDIND
AUDCH	1				
AUDFEE	0.06378	1			
BSIZE	0.12002	0.57576	1		
COMP	0.33601	0.039961	-0.07155	1	
BDIND	0.0480023	0.226959	0.37263	-0.186083	1

Source: Researchers compilation (2019)

Table 4.2 shows the correlation statistics for the variables. The correlation coefficient that is of particular interest to us in this study is the correction between Audit fee, Complexity, Board size, Board independence and Audit firm choice. As seen, AUDCH is positively correlated with AUDFEE (r=0.063), board independence (r=0.048), COMP (r=0.336), and Board size (r=0.1200). The positive correlation implies that the choice of a particular type of auditor can be associated with an increase in the variable and vice-versa. However, correlation analysis is limited in its inferential abilities since it does not

necessarily imply functional dependence between the variables. Regression analysis is more suitable for inferences as it implies functional dependencies between variables. The regression result is presented below.

Table 4.3: Regression Result

Dependent	*Variable = AUDCH Aprori sign*	*Binary LOGIT estimation*	*Binary PROBIT estimation*
C		-5.3714* (1.6825) {0.0014}	-3.3482* (-3.3428) {0.0008}
AUDFEE	+	0.2981* (0.1167) {0.0107}	0.1863* (0.0697) {0.0075}
BS	-	0.0005 (0.0042) {0.8770}	-0.0202 (0.0452) {0.6555}
COMP	-	0.16620* (0.0516) {0.0013}	0.09153* (0.0253) {0.0003}
BDIND	+	0.6317 (1.0351) {0.5416}	0.4390 (0.6421) {0.4942}
		Model Parameters	
McFadden R^2		0.5583	0.5577
LR.stat		45.7116	45.5427
P(LR-stat)		0.0000	0.0000
Mean of d.v		0.5358	0.5358
S.D of d.v		0.4999	0.4999

Source: Researchers compilation (2019

Table 4.3 above is the regression result for the estimation of the model specified earlier in the previous chapter. The binary regression (Logit & Probit) is used in this study because of the nature of the dependent variable. Binary regression deals with situations in which the observed outcome for a dependent variable is a dummy indicator variable that can have only two possible outcomes "0" and "1". In the case of this study, the dependent variable of auditor choice is a dummy indicator that assumes a value of "1" if a firm chooses a big 4 audit firm and "0" if otherwise. Logit and Probit are part of the family of binary regression though based on different distributional assumptions. Regressing the independent variables on AUDCH using the Logit regression, the McFadden R^2 for

model is 55.83 which implies that the model explains about 55% of the systematic variations in the dependent variable. The LR-stat is 45.7116 (p-value = 0.00) is significant at 5% and suggest that the hypothesis of a significant linear relationship between the dependent and independent variables cannot be rejected. It is also indicative of the joint statistical significance of the model. Focusing on the performance of the coefficients, we observe that AUDFEE is positive (0.2981) and also statistically significant at 5% level (p=0.0107). The coefficient for BS is (0.005) though not statistically significant at 5% level (p=0.8770), BDIND is positive (0.6317) and also not statistically significant at 5% level (p=0.5416), while COMPL is also positive (0.16620) but significant at 5% (p=0.0013). Regressing the independent variables on AUDCH using the Binary Probit regression, the McFadden R^2 for model is 55.77 which is similar to that found for binary logit and implies that the model explains about 55% of the systematic variations in the dependent variable. The LR-stat is 45.5427 (p-value = 0.00) is significant at 5% and suggest that the hypothesis of a significant linear relationship between the dependent and independent variables cannot be rejected. It is also indicative of the joint statistical significance of the model. Focusing on the performance of the coefficients, we observe that AUDFEE is positive (0.1863) and also statistically significant at 5% level (p=0.0075). The coefficient for BS is negative (-0.0202) though not statistically significant at 5% level (p=0.6555), BDIND is positive (0.4390) and also not statistically significant at 5% level (p=0.4942), while COMPL is also positive (0.09153) and significant at 5% (p=0.0003).

Hypotheses Testing

Decision Rule

We accept the null hypothesis if the probability value for the coefficient is > 0.05 at 5% significance level, otherwise we reject the null and accept the alternative.

H_{01}: Firm complexity has no significant influence on Auditor choice of manufacturing companies.

Focusing on the performance of the coefficients for both the binary logit and probit results, we observe that the coefficient for complexity using the Logit regression is positive (0.16620) and significant at 5% (p=0.0013). Using the Binary Probit regression, the coefficient for COMPL is also positive (0.09153) and significant at 5% (p=0.0003). Hence we reject the null hypothesis that Firm complexity has no significant influence on Auditor choice of manufacturing companies.

H_{02}: Board independence has no significant influence on Auditor choice of manufacturing companies.

Focusing on the performance of both the binary logit and probit results. Using the Logit regression, the coefficient for BDIND is positive (0.6317) and also not statistically significant at 5% level (p=0.5416), Regressing the independent variables on Auditor choice using the Binary Probit regression, the coefficient for BDIND is positive (0.4390) and also not statistically significant at 5% level (p=0.4942). On the overall, we cannot reject the null hypothesis that board independence has no significant influence on auditor choice of manufacturing companies.

H_{03}: Board size has no significant influence on Auditor choice of manufacturing companies.

Focusing on the performance of for both the binary logit and probit results. Using the Logit regression, the coefficient for BS is (0.005) though not statistically significant at 5% level (p=0.8770)

Regressing the independent variables on Auditor choice using the Binary Probit regression, the coefficient for BS is negative (-0.0202) though not statistically significant at 5% level (p=0.6555), and also not statistically significant at 5% level (p=0.4942). On the overall, we cannot reject the null hypothesis that board size has no significant influence on auditor choice of manufacturing companies.

H_{04}. Audit fees have no significant influence on Auditor choice of manufacturing companies.

Focusing on the performance of the coefficients for both the binary logit and probit results, we observe that the coefficient for AUDFEE is positive (0.2981) and also statistically significant at 5% level (p=0.0107). Using the Binary Probit regression, we observe that AUDFEE is positive (0.1863) and also statistically significant at 5% level (p=0.0075). Hence we reject the null hypothesis that Audit fees have no significant influence on Auditor choice of manufacturing companies.

DISCUSSION OF RESULT

***Firm Complexity and* on Auditor choice**

Both the binary logit and probit results, we observe that the coefficient for complexity using the Logit regression is positive (0.16620) and significant at 5% (p=0.0013) and is also positive (0.09153) and significant at 5% (p=0.0003) using binary probit. The results imply that the complexity of the client has a significant effect on the likelihood that a firm will select a big 4 audit firm. It is argued that the more complex the client firm is, the greater the number and the more diversified the subsidiaries and operations which necessitate more audit work; therefore, bigger audit firms may be employed . Sandra and Patrick (1996) showed that auditors of highly complex firms are often the big 4 auditors. According to them, foreign subsidiaries have to abide by a variety of legislative and proficient requirements for disclosure, which necessitates further audit testing, requiring more time and additional manpower to complete the audit process. Therefore, auditee complexity has a positive correlation with the auditor choice (Firth, 1997; Butterworth and Houghton, 1995; Carson Fargher, Simon and Taylor (2004). As a result, organizations that are complex are more likely to select a high quality auditor (Abdel-Khalik 1993; Hay and Davis 2004). The choice of auditor is influenced by the degree of the complexity of the engagement. Manufacturing sector is relatively more complex and big in size in conducting their transactions and activities than companies in the service sector (Abdul Latif et al., 2013). Furthermore, manufacturing companies are bigger and need considerable capital investment, therefore, maybe expected to increase funds via bank borrowing and thus, they tend to record many transactions, therefore, the auditors should perform more auditing procedures, which result in their need for an auditor that has the capacity for such complexity

Audit Fee and Auditor choice

Both the binary logit and probit results, show that the coefficient for AUDFEE is positive (0.2981) and also statistically significant at 5% level (p=0.0107) and also positive (0.1863) and also statistically significant at 5% level (p=0.0075). The results imply that the amount of fees charged by the audit firm has a significant effect on the likelihood that a firm will select a big 4 audit firm. The audit fees paid by companies to their auditors are obviously of interest to both companies and auditors. As stated earlier, the relationship between audit fees and auditor selection is a straight one. Companies are at different levels financially and this implies that their ability to also incur cost will differ

considerably. Most firms are unable to bear the cost of hiring big 4 auditors because of their fee charge. Consequently, these firms will shift to the next available auditor with fees that are affordable. It is well know that big audit firms tend to charge higher fees because of their expertise, size and reputation effect amongst others. Most big 4's are often affiliated and have a wide network of offices, workforce and competencies.

Board Independence and Auditor choice

Focusing on the performance of both the binary logit and probit results. Using the Logit regression, the coefficient for BDIND is positive (0.6317) and also not statistically significant at 5% level (p=0.5416), Regressing the independent variables on Auditor choice using the Binary Probit regression, the coefficient for BDIND is positive (0.4390) and also not statistically significant at 5% level (p=0.4942). On the overall, we cannot reject the null hypothesis that board independence has no significant influence on auditor choice of manufacturing companies. On the relationship between corporate governance and auditor choice there are two conflicting views, namely, the agency theory view and the audit production view available in literature to explain the relationship between both. **The finding is in tandem with** Abdullah et al. (2008) which found a positive though insignificant relationship between board independence and the type of auditor selected to achieve audit quality.

Board size and Auditor choice

Focusing on the performance of for both the binary logit and probit results. Using the Logit regression, the coefficient for BS is (0.005) though not statistically significant at 5% level (p=0.8770) Regressing the independent variables on Auditor choice using the Binary Probit regression, the coefficient for BS is negative (-0.0202) though not statistically significant at 5% level (p=0.6555), and also not statistically significant at 5% level (p=0.4942). On the overall, we cannot reject the null hypothesis that board size has no significant influence on auditor choice of manufacturing companies. On the relationship between corporate governance and auditor choice there are two conflicting views, namely, the agency theory view and the audit production view available in literature to explain the relationship between both. These views also account for the mixed evidence (Knechel & Willekens, 2006). For instance, Abbott (2003); Boo and Sharma (2008); Goodwin-Stewart (2006); O'Sullivan (2000) and Zaman, Hudaib, Haniffa, (2011), Goodwin and Kent (2006); and Mitra, Hossain and Deis, (2007)

SUMMARY OF FINDINGS, CONCLUSION AND RECOMMENDATION

Summary of Findings

The summary of the study findings are as follows;

i. The coefficient for Complexity is positive and statistically significant at 5% level and this implies that complexity of the firm has significant influence over the likelihood that a firm selects a particular type of auditor.
ii. Focusing on the performance of the corporate governance variables, on the overall, corporate governance has no significant influence over the likelihood that a firm selects a particular type of auditor.
iii. The coefficient for audit fee is positive and statistically significant at 5% level and this implies that the audit fee of the firm has significant influence over the likelihood that a firm selects a particular type of auditor

Conclusion

Auditor choice is a very important issue in most companies today. It is a decision that is

critical for both management and shareholders alike. This is because of the very key role that auditors play in reducing information asymmetry, monitoring and ensuring that financial information is credible and also serving as an instrument of addressing agency conflict issues. Thus the choice of the audit firm is one decision that a firm pays close attention to. Several factors exert varying degree of influence on this auditor choice decision ranging from factors related to the audit firms that are in the audit market or factors relating to the audit client. This study focuses on determinants of auditor choice by manufacturing companies focusing on a mixture of both audit firm factors such as the audit fee and then the audit client factors such as complexity and corporate governance. Using the binary regression technique, the study found that the audit fees and firm complexity has significant influence over the likelihood that a firm selects a particular type of auditor.

Recommendation

Firstly, the study recommends that since audit fees play a very significant role in influencing over the likelihood that a firm selects a particular type of auditor, there may be need for regulation of audit pricing so as not to take the big 4 auditors above the reach of most firms. Again audit clients must efficiently look at the cost and benefits analysis before selecting a particular audit firm

Secondly, complexity also stands out in influencing the likelihood that a firm selects a particular type of auditor. Hence the study recommends that companies must also ensure that complexity comes with increases in revenue generated to sustain the choice of the big 4 for those firms that prefer that option.

Finally, the study recommends that audit quality and audit service delivery of all audit firms whether big 4 or non-big 4 should be of the highest quality possible.

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