

# Audit Firm Characteristics and Litigation Risk in Nigeria

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## ABSTRACT

*This study investigates the relationship between audit firm characteristics and litigation risk in Nigeria. The population of the study comprises all the audit firms in audit practice in Nigeria that are registered with the Institute of Chartered Accountants of Nigeria (ICAN) as at 31st December, 2014. Using the judgmental sampling technique, 20 Nigerian audit firms were chosen. From the 20 selected audit firms, a final sample of 156 respondents (representing 78% response rate) who have been in audit practice for over 3 quinquennia was drawn. Data was estimated using ordinary least squares regression method. Audit fee and litigation were positive and statistically significant. Whereas audit tenure and audit firm size, introduced into the model as control variables, were statistically insignificant, non-audit fee was negatively related to litigation risk. Against the background of the findings, we recommend that partners in audit firms should always endeavour to evaluate the attributes of their firms, or possibly link those attributes to the risk of being sued for a deficient work, as understanding the link between audit-firm characteristics and litigation risk would allow firms to further reduce litigation risk through practice management. The study noted that the demise of Arthur Andersen (one of the big 5 audit firms) can be largely attributed to the partners' inability to identify changes within their firm that increased the risk of audit failure and litigation to an unreasonable level.*

**Keywords:** Litigation risk, audit firm, audit independence, audit fees, audit quality

## INTRODUCTION

Users of financial statements such as the banks, financial analysts and shareholders usually base their loan and investment decisions largely on information in financial statements. To enable them to take the right decisions, these financial statements should provide reliable and objective information about the company's financial situation. However, since information presented in financial statements has huge impact on managers' compensation and the way they are evaluated, users are not sure if these financial statements have been properly prepared, and therefore demand that the financial statements be audited by an independent external auditor (Gul, Jaggi and Krishnan, 2007). Naturally, it is essential that these auditors are indeed independent and that they carry out the audit in such a way that all (material) errors in the financial statements are discovered. In recent years however, concern about a lack of independence in auditors due to over dependence on fees from providing other

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services to clients has been expressed by the government, regulatory authorities, academic researchers and the accounting profession itself (Gul, Jaggi and Krishnan, 2007). They emphasize the fact that clients' directors/managers control the current and future audit (and consultancy) fees that the audit firm hopes to obtain from the relationship with the auditee, and therefore are in a powerful position in audit conflict situations. Empirical studies indicate that directors and managers often exert pressure on auditors in audit conflict situations by (subtle or overt) threatening to break off the relationship with the audit firm, and that auditors are perceived as yielding more easily to this pressure if they profit more from the audit (Knapp, 1985; Farmer, 1987; Gul, 1991a and Bartlett, 1993).

Several studies have shown that increasing competition in the audit market has led to increasing pressure on audit time budgets, often causing these budgets to become very tight (Marxen, 1990 and Otley and Pierce, 1996). Research has also shown that these tight budgets often lead to auditors omitting parts of the audit program, and thus lower audit quality (Margheim and Pany, 1986; McDaniel, 1990; Kelley and Margheim, 1990 and Otley and Pierce, 1996). If auditors lower the quality of the audit by yielding to management pressure or by omitting parts of the audit program, the risk of financial statements containing material errors will of course increase. However, not all errors in financial statements will harm the audit firm or the auditor who audited the statements.

Problems only occur when users of financial statements discover these errors and these errors have led to financial losses. In that case, users will try to recover their losses by filing lawsuits and claims against the auditor who wrongly approved the statements or had performed a deficient audit work. Palmrose (1988) has demonstrated that such lawsuits and claims lead to high costs and a greatly damaged reputation and as a result, are very harmful to the auditor and the audit firm. Therefore, it may be expected that auditors' willingness to yield to management pressure and to omit parts of the audit program will decrease if there is a high possibility that poor audit work will increase litigation risk.

Although, numerous researches have been extensively done as regards audit litigation, most empirical assessments in this area have not only been predicated on data from developed countries, notably Anglo-American and Europe, but the focus has been on the relationship between audit-client characteristics and audit litigation. Studies on relationship between audit-firm characteristics and audit litigation have been quite limited with the exception of few notably studies (Stice, 1991 and Casterella, Jensen and Knechel, 2007). Our study, therefore, extends and contributes to extant literature by offering empirical evidence on the relationship between audit-firm characteristics and litigation risk using, as a reference point, audit firms that have been in audit practice in Nigeria for over three *quinquennia*.

### **Audit Litigation Risk**

Litigation risk can be regarded as any breakdown in audit quality that results in a claim alleging professional malpractice against an auditor and/or its insurer (Hwang and Chang, 2010). Depending on the circumstances, this may manifest as a formal lawsuit or simply as a claim against the auditor's insurance company that is settled without formal litigation.

Audit litigation risk is determined primarily by features of the audit engagement. This includes attributes of the audit firm and the audit client, as well as their interactions. Previous research indicates that certain audit-client characteristics are associated with audit failure and litigation risk (Latham and Linville, 1998). Some audit firms actively cull from their portfolios clients with such characteristics. However, insurers of audit firms generally cannot observe the characteristics of individual audit clients. Instead, they must make risk decisions using the available information about the audit firms themselves. Understanding the link between audit-firm characteristics and litigation risk is important to anyone interested in differentiating quality among audit firms (Hwang and Chang, 2010). This includes Organizations seeking high-quality audits, but is of particular import to audit firms themselves and to companies who insure them against audit failure.

An audit failure is said to have occurred when an observed event (e.g., bankruptcy, subsequent discovery of material error or fraud, restatement) is linked to the auditor's alleged failure to perform an effective audit'. Audit firms can manage litigation risk by screening potential clients (Johnstone 2000; Asare, Hackenbrack and Knechel, 1994) and by eliminating risky clients from their portfolios (Johnstone and Bedard, 2004). However, partners in audit firms are not always well-placed to evaluate the attributes of their own firms, or to link them to the risk of being sued for deficient work. Neither are they free from potential bias and self-deception in making such assessments (Bazerman, Loewenstein and Moore, 2002). Indeed, the demise of Andersen can be attributed largely to partners' inability to identify changes within their firm that increased the risk of audit failure to unreasonable levels (Toffler, 2003). Hence, understanding the link between audit-firm behaviour and litigation risk should allow firms to further reduce litigation risk through practice management.

Litigation risk can be viewed in terms of the likelihood of a claim being filed alleging audit failure (Stice, 1991; Lys and Watts 1994), but also in terms of the magnitude (or Naira amount) of such claims. Although extant research has generally used the likelihood measure alone, it is clear that audit failures resulting in small naira losses are more tolerable than audit failures resulting in catastrophic losses. Insurance models outside of accounting frequently incorporate the severity of the litigation loss (Cummins and Derrig, 1993). Hence in this study, litigation risk is defined by both its likelihood and magnitude.

### **Audit - Firm Characteristics**

Previous accounting research has addressed the issue of audit litigation by identifying problem areas that should be considered while performing audit (Kellogg, 1984; St. Pierre and Anderson, 1984). Stice (1991) extends this research by developing and testing a model to predict litigation against auditors which includes both client and auditors' characteristics. According to the researcher, while audit-client characteristics include financial conditions, level of accounts receivable and inventory, sales growth, market value of equity, and variability in the client's stock returns, audit-firm characteristics include audit quality, audit independence, and audit tenure. The audit-firm characteristics used in this study were adapted from the ones developed by Stice in 1991.

### **Audit Fees and Litigation Risk**

The work of Beatty (1993) is one of the first studies to focus on the relationship between litigation risk and audit fees - a relation he characterized as “the legal liability hypothesis”. According to him, as the expected losses from imposition of legal liability increases, the audit fee will increase, *ceteris paribus*. For Francis and Krishnan (1999), one way in which auditors can respond to an engagement’s perceived audit and litigation risk is to adjust their audit fees accordingly. While frictions may prevent auditors from fully adjusting audit fees upwards to reflect higher perceived level of litigation risk, it is expected that auditors, on average, will charge higher fees for two reasons. First, audit fees will increase the extent auditors expand audit scope and assign more (and more experienced) professional staff to help mitigate these risks (Simunic and Stein, 1996). Second, auditors may charge a risk premium to compensate them for the additional audit risk the audit engagement entails (Abbott, Parker and Peters, 2006; Chen, Krishnan and Pevzner, 2012; Krishnan, Pevzner and Sengupta, 2012). On the other hand, audit clients expect the auditor to carry out quality audit after being charged so much for the audit. In the event of any financial loss from negligently performed audit, the injured party may file lawsuit against the auditor. It is therefore important for auditors to understand how client characteristics are related to audit and litigation risk so as to be able to assess risk levels and institute appropriate audit procedures (Stice, 1991). The audit pricing literature provides evidence that auditors respond to higher perceived audit and litigation risks by demanding higher audit fees (Hwang and Chang, 2010). Simunic (1980) finds that proxies for auditors’ expected litigation costs are positively associated with current period audit fees.

### **Audit Independence and Litigation Risk**

There is a long-standing view that auditor independence is threatened by the economic dependence of an auditor on fees from audit clients. The additional fees obtained through the provision of non-audit services increase an auditor’s economic dependence on a client, and this has been perceived by regulators and concerned stakeholders to threaten auditor independence. Prior research does provide some evidence to suggest that the volume of non-audit services provided by auditors impairs perceived auditor independence, threaten audit quality and increases audit litigation risk (Frankel, Johnson and Nelson, 2002; Brandon, Crabtree and Maher, 2004; Krishnan, Heibatollah and Zhang, 2005; Francis and Ke, 2006; Khurana and Raman, 2006). In an experimental study, Dopuch, King and Schwartz (2003) also establish that provision of non-audit service affect perceived auditor independence and increases the chances of lawsuit and claims by injured parties.

Francis (2006) argues that fees from the provision of all services (audit and non-audit services) create economic dependence and could be perceived to threaten audit independence. Gul (1991b); Gul, Basioudis and Ng (2011), note that the amount of audit fees rather than NAS fees affects perceived auditor independence. On the other hand, Ghosh, Kallapur and Moon (2009) establish that client importance (that is to say, contributing a large proportion of revenues to an auditor’s total revenue stream) rather than fees from non-audit service impair perceived auditor independence.

### **Non-audit Service Fee and Litigation Risk**

Prior research indicates that the provision of non-audit services creates economic bonds with a client and this bond can weaken an auditor's independence and audit quality (DeAngelo 1981; Simunic 1984; Beck, Frecka and Solomon, 1988) and therefore increases litigation risk. Conversely, DeFond, Raghunandan and Subramanyam (2002) empirically demonstrate that firms that pay high non-audit fees are not associated with the incidence of going concern opinions, suggesting that auditor independence, as well as audit quality, is not compromised with high payment of non-audit fees, thereby reducing auditors' liability exposure. Using client-specific ex-ante cost of equity as a proxy for investor perceptions of financial reporting reliability, Khurana and Raman (2006) discover that high non-audit and total fees are associated with lower financial reporting credibility. However, concerns about reputation (Watts and Zimmerman 1983) and litigation exposure (Palmrose 1988; Shu, 2000) are likely to motivate auditors to be more independent in carrying out their audit and non-audit works.

### **Audit Quality and Audit Litigation Risk**

Research has demonstrated that if audit firms lower the quality of their audit work by yielding to management pressure or by omitting parts of the audit program, the chance of financial statements containing material errors and misstatement would be high. However, not all errors in financial statements will harm the audit firm or the auditor who audited the statements. Problems arise only if users of financial statements discover these errors and if these errors cause financial losses. Thus, injured parties would try to recover their losses by filing lawsuits and claims against the erring audit firm. Research by Palmrose (1988) has shown that such lawsuits and claims lead to high costs and a greatly damaged reputation, and therefore are very harmful to the auditor and the audit firm. For this reason, auditors would provide higher quality audit in order to reduce exposure to audit litigation (Palmrose, 1988). Dye (1993) predicts audit quality as having a negative relationship with lawsuit and claims by injured parties. In his analytical model, he linked perceived quality of an audit to the auditor's wealth. Based on this "deep pocket" theory, it could be argued that auditors provide higher quality audit because they have more wealth at risk in case of litigation. It follows that the higher the quality of audit auditors would perform, the lower the perceived litigation risk.

## **METHOD**

A framework for the analysis of the relationship between audit firm characteristics and audit quality is the stakeholder theory. The stakeholder theory, originally defined by Freeman (1984) 'is a theory of organizational management and business ethics that addresses morals and values in managing an organization'. In this theory, the concept "stakeholders" refers to managers, shareholders or other users of financial reports which are influenced, either directly or indirectly by the actions of the auditor. A fundamental characteristic of stakeholder theory is therefore to attempt to identify individuals and groups that Organizations and companies are accountable to. This has also been part of the theory's challenge (Anheier, 2005).

Variations in stakeholders' perception about lawsuits and claims for poorly executed audit work that causes financial losses suggest that no single element should be adjudged as having the dominant influence on audit litigation explained in this study as "audit fees", "audit independence", "audit quality", and "non-audit service fee". This means that a broader and deeper understanding of the complexities of the issue needs to be addressed more holistically in line with the response divergent stakeholder's theory (Freeman, 1984) through investigating the impact of these variables. Consequently, different stakeholders should carefully analyze their actions so as to establish the effects of their actions on the perspectives of audit litigation because audits provide assurance to shareholders, managers, investors, payables and other stakeholders for the purpose of instilling confidence in financial reporting.

Following the above framework, and existing extant literature on the audit-firm attributes that impacts on audit related-litigation, we therefore assume that audit litigation risk is a function of audit fees, audit independence, non-audit services and audit quality:

$$AUDLITRISK = f (AUDFE, AUDIND, NAS, AUDQUAL)$$

In order to measure the effect of other external factors that can be responsible for any disparity in the relationship between audit-firm characteristics and audit litigation risk, there was the need for the introduction of control variables. The control variables selected in this study are audit tenure and audit-firm size. Thus, incorporating these control variables into the above linear function will produce the following new function:

$$AUDLITRISK = f (AUDFE, AUDIND, NAS, AUDQUAL, AUDTEN, AUDFSIZ)$$

Expressing the above function in econometric form will produce the following equation:

$$AUDLITRISK = B_1AUDFE + B_2AUDIND + B_3NAS + B_4AUDQUAL + B_5AUDTEN + B_6AUDFSIZ + \mu_i$$

Where: AUDLITRISK	=	Audit litigation risk
AUDFE	=	Audit fees
AUDIND	=	Audit independence
NAS	=	Non-audit service fees
AUDQUAL	=	Audit quality
AUDTEN	=	Audit tenure
AUDFSIZ	=	Audit firm size
$\mu_i$	=	error term
$B_1, \dots, B_6$	=	unknown coefficients of the variable.

Presumptively, it is expected that  $B_1 < 0$ ,  $B_2, B_3, B_4, B_5, B_6 > 0$ .

The population of the study comprises all the audit firms in audit practice in Nigeria that are registered with the Institute of Chartered Accountants of Nigeria (ICAN) as at 31st December, 2014. Using the judgmental sampling technique, 20 Nigerian audit firms were chosen. The study was restricted to Lagos State as it harbours 60% of the Federation's total industrial investments and foreign trade and attracts 65% of Nigeria's commercial

activities (The Academy of Business Strategy 2011 cited in Olayinka, 2012). From the 20 selected audit firms, a sample of 200 chartered accountants who have been in audit practice for over 3 quinquennia was drawn, and they are between the ages of 40 and 60 years. Content validity was achieved through a pilot scheme in which copies of the questionnaire were administered on some few selected respondents. Their responses were used to adjust the questions. Three research assistants were commissioned to administer the questionnaire. There was a response rate of 78% having received and analyzed 156 copies of the questionnaire. The questionnaire included items adopted from previous researches as well as some self developed ones. The questionnaire consisted of two sections: Section A was in the format of a five-point Likert type scale. This section investigated the seven variables of interest used in the study (see table 1). Section B gathered demographic information from the respondents.

**Table 1:** Measurement of Variables

<b>Variables</b>	<b>Questions</b>	<b>sign</b>
Audit litigation risk (AUDLITRISK)	1 – 4	
Audit fees (AUDFE)	5 – 8	+ ve
Audit independence (AUDIND)	9 – 12	+ ve
Non-audit service fees (NAS)	13 – 16	+ ve
Audit quality (AUDQUAL)	17 – 20	- ve
Audit tenure (AUDTEN)	21 – 24	+ ve
Audit firm size (AUDFSIZ)	25 – 30	- ve

**Source:** Expository Survey, 2016

Data obtained from the questionnaire were analysed using Ordinary Least Squares regression method.

## **RESULTS AND DISCUSSION**

The correlation result below (table 2) revealed that the coefficient of the variable with respect to itself is (1.00) signaling perfect correlation. The values of the mixed coefficients are not indicative of any problem of multicollinearity. The highest correlation coefficient of (0.443) between audit tenure and audit firm size is a strong indication of absence of multicollinearity. The result of the correlation coefficient was strengthened by the Variance Inflation Factor (VIF) test. From the results as presented on table 3, it was observed that none of the variables tested indicates the presence of multicollinearity as the centered VIF of the variables are all less than 10. The result of the Breusch-Pagan-Godfrey (table 4) test shows the absence of heteroskedasticity with a probability value of (0.1204) which is greater than the 5% critical value. The result of the Breusch-Godfrey serial correlation test (table 5) shows f-statistic and obs\* R-squared values of (0.67) and (1.69) with probability values of (0.58) and (0.56) which indicates the absence of serial correlation. The Durbin-Watson statistic of (1.998687) is substantially close to (2.00) and indicates the absence of serial correlation. As reported on table 6, the OLS result revealed that 62% of the variation

in audit quality is explained by the explanatory variables while the balance of 38% variation is attributable to the error term. On the basis of the overall model significance, the f-statistic of (56.4) exceeds the f-critical value at 5% level which explains the fitness of the specified model.

Also, as shown on table 6, audit fee (AUDFEE) was found to be positive and significant with a robust t-value of (10.04627) and the coefficient of (1.178158). This means that auditors would respond to an engagement's perceived audit and litigation risk by adjusting their audit fees accordingly. On the other hand, after paying so much fees and the audit is carried out negligently to the extent that the client suffers some financial loss, the client will go to court to recover such loss, indicating that high audit fees could increase litigation risk if there is an audit failure. The hypothesis 1 which proposes a positive relationship between litigation risk (AUDLITRISK) and the audit fees (AUDFEE) charged to that auditor's clients is therefore upheld. This finding is supported by studies of Simunic, (1980), Simunic and Stein (1996), and Hwang and Chang (2010) who provide evidence that auditors respond to higher perceived audit and litigation risks by demanding higher audit fees. The audit fees will increase the extent auditors expand audit scope and assign more (and more experienced) professional staff to help mitigate these risks.

The relationship between highly impaired audit independence (AUDIND) and litigation risk (AUDLITRISK) was found to be positive and significant with a t-value of (0.375204) and the coefficient of (0.181347), thus supporting hypothesis 2 which proposes a positive relationship between highly impaired audit independence and litigation risk. The result corroborates the work of Frankel, Johnson and Nelson (2002); Brandon, Crabtree and Maher (2004); Krishnan, Heibatollah and Zhang (2005); Francis and Ke (2006); Khurana and Raman (2006) who have stated that impaired auditor independence threatens audit quality and consequently increases litigation risk.

Again, the relationship between audit quality (AUDQUAL) and audit litigation risk (AUDLITRISK) was found to be negative and significant with a t-value of (-2.063806) and the coefficient of (-0.466802). Thus, hypothesis 4 which proposes a negative relationship between audit quality and litigation risk is supported. This result corroborates findings of Dye (1993) and Palmrose (1988) who established a negative relationship between audit quality and lawsuit and claims by injured parties. The fact is that auditors would be more motivated to provide higher quality audit when they have more wealth at risk in case of litigation than when they do not.

Furthermore, non-audit fee (AUDFEE) was found to have a negative impact on litigation risk (AUDLITRISK). The relationship between both variables was found to be negative and significant with a t-value of (-0.343753) and the coefficient of (-0.192073). The implication of this finding is that hypothesis 3 which postulates a positive relationship between increased non-audit fees, impaired audit independence and increased litigation risk is not upheld. This means that non-audit fee (AUDFEE) may not necessarily influence the audit litigation (AUDLITRISK) via impaired audit independence. This finding deviates from those of Krishnan, Heibatollah and Zhang (2005); Francis and Ke (2006); Khurana and Raman (2006) who argue that the amount of NAS fees paid to auditors impairs



perceived auditor independence, threaten audit quality and increases audit litigation risk and lawsuits, but corroborates those of Ghosh, Kallapur and Moon (2009) and DeFond, Raghunandan and Subramanyam (2002). Audit tenure (AUDTEN) was found to have positive and insignificant relationship with audit litigation risk (AUDLITRISK) with a t-value of (0.334868) and coefficient of (0.006581). This shows that higher audit-client relationship increases the chances of litigation risk due to threat of over familiarity with the audit client arising from many years of audit engagement even though the impact is statistically insignificant in this study. Finally, the relationship between audit firm size (AUDFSIZ) and audit litigation (AUDLITRISK) was negative but insignificant, meaning that the larger the size of the audit firm, the less likelihood of the audit firm being exposed to audit litigation due to the availability of the required capacity to carry out quality audit. Given the result of this study, the audit firm size did not exert significant impact on audit litigation. That is, with a negative coefficient of (-0.021074) and a t-value of (-0.239874), results show that audit firm size does not significantly influence audit litigation in Nigeria.

**Table 2:** Spearman Correlation Analysis

	AUDLITRISK	AUDFE	AUDIND	NAS	AUDQUAL	AUDTEN	AUDFSIZ
<b>AUDLITRISK</b>	Corr. Coeff. Sig. (2 tailed) N	1.000 -					
<b>AUDFE</b>	Corr. Coeff. Sig. (2 tailed) N	0.242 0.109	1.000 -				
<b>AUDIND</b>	Corr. Coeff. Sig. (2 tailed) N	0.127 0.160	0.323 0.005	1.000 -			
<b>NAS</b>	Corr. Coeff. Sig. (2 tailed) N	0.078 0.332	0.163 0.061	-0.506 0.016	1.000 -		
<b>AUDQUAL</b>	Corr. Coeff. Sig. (2 tailed) N	0.380 0.078	0.021 -0.071	0.320 0.130	0.331 0.000	1.000 -	
<b>AUDTEN</b>	Corr. Coeff. Sig. (2 tailed) N	0.045 0.517	-0.068 0.912	-0.075 0.341	0.369 0.530	0.223 0.130	1.000 0.223
<b>AUDFSIZ</b>	Corr. Coeff. Sig. (2 tailed) N	0.164 0.618	0.091 0.477	0.090 0.982	0.321 0.630	0.092 0.543	0.443* 0.530
		156	156	156	156	156	156

*Source:* Researchers' Compilation, 2016. \*Correlation is significant at the 0.01 level (2-tailed)

**Table 3:** Variance Inflation Factor

Variables	Coefficient Variance	Uncentered VIF	Centered VIF
<b>C</b>	0.161181	79.01258	NA
<b>AUDFE</b>	0.005245	15.52182	1.067593
<b>AUDIND</b>	0.004708	11.34624	1.171325
<b>NAS</b>	2.46E-05	14.69785	1.121076
<b>AUDQUAL</b>	1.87E-07	13.04229	1.075219
<b>AUDTEN</b>	0.003788	46.38717	1.060444
<b>AUDFSIZ</b>	0.006750	68.51713	1.057788

*Source:* Researchers' Compilation, 2016

**Table 4:** Heteroskedasticity Test: Breusch-Pagan-Godfrey

F-statistic	1.738452 Prob. F(6,146)	0.1204
Obs* R-squared	9.649687 Prob. Chi-Square (6)	0.1204
Scaled explained SS	12.83464 Prob. Chi-Square (6)	0.0466

*Source:* Researchers' Compilation, 2016

**Table 5:** Breusch-Godfrey Serial Correlation LM Test

F-statistic	0.674190 Prob. F(2,146)	0.5806
Obs*R-Squared	1.693843 Prob. Chi-Squared (2)	0.5642

*Source:* Researchers' Compilation, 2016

**Table 6:** Ordinary Least Square (OLS) Regression Analysis

Variables	Coefficient	Std. Error	t-statistic	Prob.
AUDFE	1.178158	1.108865	10.04627	0.0002
AUDIND	0.181347	0.426362	0.375204	0.6641
NAS	-0.192073	0.473426	-0.343753	0.7337
AUDQUAL	-0.466802	0.182631	-2.063806	0.0465
AUDTEN	0.006581	0.075363	0.334868	0.8385
AUDFSIZ	-0.021074	0.385314	-0.239874	0.5887
R-squared		Mean dependent var	6.091444	
0.623501		S. D. dependent var	6.877629	
Adjusted R-squared		Akaike info criterion	6.390939	
0.568720		Schwarz criterion	6.702374	
S. E. of regression		Hannan-Quinn Criter	6.639875	
2.575253		Durbin-Watson stat.	1.998687	
Sum squared resid				
1859.149				
Log likelihood				
-307.0827				
F-statistic				
56.42274				
Prob (f-statistic)				
0.000000				

*Source:* Researchers' Compilation, 2016

## CONCLUSION AND RECOMMENDATIONS

The study investigated the relationship between audit firm characteristics and litigation risk in Nigeria against the backdrop of the vulnerability of the auditing profession to reputation-damaging lawsuits by injured parties arising from negligence and poorly executed audit work which has been described as a crisis. Given the peculiarities of this study, it was hypothesized that audit fees is positively related to litigation risk. The reason being that an injured audit client can easily file lawsuits and claims to recover the financial losses suffered from negligently carried out audit work which has cost the client so much. The study hypothesized an inverse (negative) relationship between audit quality and litigation risk. This means that to reduce any legal related liability, auditors are motivated to provide higher quality audit especially if huge amount of their wealth is at risk. Against expectation, the result of the present study showed a negative relationship between non-audit fee and litigation risk. The fact that extant literature has demonstrated that the provision of non-audit services creates economic bonds with a client, which weakens auditor's independence as well as audit quality and increases litigation risk, one expects that the results would have produced a positive relationship between non-audit fees and litigation risk. Rather both variables were found to be negatively related and statistically significant, showing that non-audit fee has no influence on audit litigation. The study also revealed a positive and statistically

significant relationship between highly impaired audit independence and litigation risk. An auditor who is not independent would hardly carry out quality audit that would reduce litigation risk. Although, the study found a positive but insignificant relationship between audit tenure and litigation risk, the same cannot be said of the relationship between the other control variable (audit-firm size) and litigation risk, as a negative relationship was rather found between both variables, indicating that the availability of the required capacity in large audit firms would enable the firms perform quality audit and thus reduce their exposure to litigation risk. However, as the result of this study is insignificant, one would hardly conclude that audit-firm size reduces litigation risk in Nigeria.

Based on the findings of this study, the following recommendations are made. Firstly, audit firms should only accept engagements that require them to provide audit and non-audit services if they have the capacity to manage both types of engagement. To avoid familiarity threats which could subsequently impair independence, audit firms should ensure that certain members of staff are not allowed to remain on an assignment for too long. Over familiarity with clients can affect audit independence, lower audit quality which exposes the audit firm to litigation risk. Secondly, since the result of this study has shown that audit firm size does not significantly influence audit litigation in Nigeria, smaller audit firms should be encouraged as they are more likely to perform more thorough audit assignment. Irrespective of the audit firm size, all potential audit clients should be properly screened so as to identify any risk of litigation before an engagement is accepted by the audit firm. Thirdly, partners in audit firms should always endeavour to evaluate the attributes of their firms, or to link them to the risk of being sued for deficient work. This is very important because understanding the link between audit-firm behaviour and litigation risk should allow firms to further reduce litigation risk through practice management. The demise of Andersen (one of the big 5) can be attributed largely to partners' inability to identify changes within their firm that increased the risk of audit failure to unreasonable level. Finally, the Institute of Chartered Accountants of Nigeria (ICAN) provides opportunities for members in audit practice to consult the institute where they run into any difficulty in private practice. Unfortunately, most members have not been taking advantage of this option. Seeking guidance from ICAN can help audit firms develop strategies for reducing their exposure to litigation risks.

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