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Effect of audit litigation on pricing of audit services in selected Nigerian firms

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Abstract

This paper examined the effect of audit litigation on audit fees. It also investigated the extent to which audit litigation affects auditor's reputation. The general proposition, together with its extension of reputation effects of audit litigation were tested using the population of companies listed on Nigeria Stock exchange audited by the Big Four auditors. Audit fees of firms audited by auditors who were involved in lawsuits, fines, sanctions or adverse publicity as a result of audit failures were paired with other firms whose auditors were clean from 2010-2012. Questionnaires were administered to shareholders and management of the sampled firms to generate data on the effect of audit litigation on auditors' reputation. To test the hypothesis chi-square and t-statistics were employed with acceptable probability significant level of 0.05. The result showed that: audit litigation has a significant effect on auditors' reputation; audit litigation has an adverse and significant effect on pricing of audit services. The study thus recommended that auditors should avoid any reputation tarnishing event to protect their bargaining power, retain their current clients and be able to attract new clients.

Keywords: Audit Quality; Audit Failure; Audit Litigation; Auditor's Reputation; Audit Fee

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1. Introduction

For capital markets to function reasonably well, it is essential that investors obtain a scorecard on companies performance usually presented in the form of financial statements that are standardised across firms and prepared under specific guidelines. Financial statements are considered useful to the extent that they are credible, while auditors play an important role in ensuring that accounting statements are accurate and are prepared following the accepted guidelines. The demand for auditing arises from this auditor's monitoring role in the principal-agent relationship (Dang, 2004). Thus, the financial statements audit is a monitoring mechanism in the sense that it helps in reducing information asymmetry thereby protecting the interests of the principals and other stakeholders. It provides reasonable assurance that the financial statements prepared by the management contain no material misstatements. Hence audit quality describes how well an audit detects and reports material misstatements of financial statements, curtails information asymmetry between management and shareholders and therefore helps protect the interests of stockholders (Dang, 2004). The inability of an audit exercise to detect a material misstatement in the financial statements and report same is seen as audit failure and could misguide the users of the financial statements. The loss resulting from the audit failure on the users of financial statements could lead to legal action against the auditor.

The principal or third party users could resort to legitimate effort to recoup losses caused by the defective audit. The auditor's liability stemmed from the fact that he is expected to do his work with due diligence, maximum honesty and carefulness (Onyekwelu and Ugwuanyi, 2014). Achieving audit quality, therefore, depends heavily on the auditor’s competence and independence. His competence is projected in his ability to execute a thorough examination of accounts and detect possible errors, and his competence is shown in his willingness to release an objective opinion on what he discovered (Arunada, 2000). Skinner and Srinivasan (2009) noted that any noticeable decline in firm's audit quality causes a reduction in the demand for its services and adverse consequences for its clients'.

Auditors compete by reputation, which is an offspring of a history of credible auditing. An audit firm known for high-quality audit earns a high reputation for itself which may in turn impact positively on the pricing of its service. Allen, Linville and Stott (2005) identified that a positive reputation accrues several benefits to the auditor which include the capacity to attract new clients, to retain existing clients, to attract the best employees, and to add a reputation premium in fees. Companies which have a reputation because their financial reporting is credible are most likely to change auditors when the quality of their audit is in doubt to avoid capital market problems that may arise as a result of unreliable financial reporting (Hennes, Leone and Milner 2012, 2014).

Pricing of audit services is mainly dependent on the audit firm’s earned reputation through the provision of a high-quality audit. Prior studies revealed that perceived audit quality positively relates to audit fees; the higher the value placed on audit examination carried out by auditors who appear to be highly competent and independent, the higher the prices paid by the auditees. However, it has been observed that in Nigeria and other developing economies auditors’ reputation is affected by audit litigation, resulting in the low pricing of audit services to be provided by the reputable audit firm. Auditors, on one hand, are very cautious of audit litigation risks which are events in audit client's company that could lead to audit failure and its consequence of audit litigation. Audit clients, on the other hand, when considering hiring or retaining an auditor, and when negotiating audit fees take into consideration whether an auditor has been involved in audit litigation case. Different kinds of literature have identified specific events preceding audit litigation, and some of the results of litigation, and other reputation reducing events for auditors. None of these literature has considered variables such as net loss, inadequate working capital, sanction, fines as audit failure threat that may lead to litigation. Moreover, these variables were neither factored into audit fee models nor consideration given to their effects on pricing of audit services.

This study investigated the existence of a relationship between audit litigation against an audit firm and the firm's audit fees charged to clients. It also tried to determine the effect of audit litigation on auditor's reputation. It focused on litigation cases, sanctions, fines and adverse publicity against auditors in Nigeria, and impact of such on subsequent audit pricing. The study argues that to address the influence of audit litigation on audit fees and auditor's reputation, variables such as net loss, inadequate working capital, sanction, and fines amongst others should be factored into audit fee models to have a comprehensive audit fee model that will reflect the audit litigation effect on the pricing of audit services. Therefore, the study seeks to achieve the following objectives:

1- To ascertain the extent to which audit litigation affects auditor's reputation.
2- To evaluate the extent to which audit litigation impacts the pricing of audit services.

The study formulated the following hypothesesformulated in line with the objectives.

- H^1: Audit litigation does not have any significant effect on auditor's reputation in Nigeria.
- H^2: Audit litigation does not have a significant impact on pricing of audit services in Nigeria.

This study contributes to the local and international literature on the effect of audit litigation on audit fee. Furthermore, the study is of significance to auditors by revealing the necessity to avoid careless audit that might lead to litigation, damage to the audit firm's reputation, reduced client base, hamper its ability to attract new clients and reduce its potential for favourable fee negotiation. To the audit clients, it will help them understand what influences the audit fees charged to them and guard against presenting financial statements with events that may lead to audit litigation. The implication is that the policymakers will provide adequate policies and procedures to guide the activities of auditors, prevent audit failure and protect capital market participants.

The remaining sections of this paper are organised as follows: section 2 discusses relevant literature; section 3 deals with the research methodology, results and discussion are presented in section 4, while Section 5 shows the conclusions along with the implications of the study, limitations, and suggestions for further research.

2. Review of related literature

2.1. Audit and audit quality

Aguolu (2008) defines auditing as the independent examination of an entity's financial statements to expressing an opinion as to the true and fair view of the statements and their compliance with the relevant statutes and the international financial reporting standards. The American Accounting Association (AAA) Committee of Basic Auditing Concept (1971) in Robertson and Louwer (1999) defines auditing as a process of systematically and objectively obtaining and examining evidence concerning declarations about economic transactions and events to ascertain the level of agreement between the assertions and established criteria and communicating the results to stakeholders.

In the words of Dang (2004), audit quality describes how well an audit detects and report material misstatements of financial statements, curtail information asymmetry between management and stockholders and therefore helps protect the interests of stakeholders. One standard definition of audit quality is provided by De Angelo (1981), She defines audit quality as joint probability assessment by the market that a given auditor will both, (a) Identified a breach in the clients accounting system and (b) Report the violation. Audit quality depends mostly on the capability of the auditor to carry out a thorough examination of the accounts and detect possible errors (technical competence), and his willingness to express an opinion on them (his independence) (Arunada, 2000). The auditor's technical competence is seen in his ability to detect possible errors while his independence is exhibited in his ability to express an audit opinion on the errors discovered during the audit. Audit quality is essential for users of accounting reports to consider financial statements credible. Audit quality also helps in verifying any claims by the management about the company activities and affairs thereby reducing the users' exposure to information risk (Fairchild (2008). Woodland and Reynolds (2003) assert that no two audits may have the same quality because of the likely differences in technical expertise and independence levels of the auditors involved.

According to Enofe *et al.*, (2014), the objective of an audit is to plan and carry out a review to obtain appropriate and sufficient audit evidence for the support of the opinion expressed in the auditor's report. Insufficient and wrong audit evidence would lead to the expression of the wrong opinion on the financial statements. Enofe *et al.*, (2014) state that the auditor may report that an entity is a going concern, while it is not. The company may eventually collapse, and this may attract litigation against company's auditors. The authors added that Enron's auditor, Arthur Andersen, suffered the massive litigation cost at the collapse of Enron, which ultimately brought about the demise of Arthur Andersen. Poor quality audit resulting from lack of appropriate and sufficient audit evidence has lead to the collapse of many corporate bodies (Enofe *et al*., 2014). Arthur Andersen failed to gather adequate audit evidence on the use of the 'special purpose entities (SPEs)' and their accounting treatment (Mallin, 2010).

2.1.1. Perceived audit quality and actual audit quality

Jackson (2008) suggests that actual audit quality is the degree to which the auditor curtailed the risk of reporting a material error in the financial statements. Perceived audit quality is how effective the users of financial statements believe that auditor is at reducing obvious and material misstatements. Dang (2004) views perceived audit quality to be based on perceptions of financial statements users, while actual audit quality refers to auditor's ability to detect and report account misstatements. The author adds that real audit quality cannot be observed but can only be assessed after audits have been conducted.

2.2. Audit failure and audit litigation

According to Okaro and Okafor (2013), in a situation where the management grossly misrepresents their financial statements, and the auditors, either by negligence or incompetence, failed to uncover and report the misrepresentations to the public, audit failure is bound to occur. Audit failure or performance gap occurs when public expectations are reasonable, but the auditor‘s performance does not fulfil them. That means that there is a shortfall in the auditor‘s performance (Okaro and Okafor 2011). It follows that audit failure stems mostly from faulty audit process which gives rise to audit ineffectiveness.

Zhiver *et al*. (1995) recognised that litigation is one of the few observable components indicating lack of audit quality and arguably the most crucial. Eu-jin and Houghton (2001) posit that litigation is perceived as an indication of audit failure, namely failure to adequately detect or reveal material misstatements or misrepresentation in the financial report. Dang (2004) refers to it as a case of substantial distortions of financial statements indicated by Security and Exchange Commission investigation or subsequent restatement of financial statements. Eu-jin and Houghton (2001) opined that the common understanding of a suit is that audit quality has been compromised thereby justifying any accusation of audit negligence.

Imeokparia (2013) reported that in 2008, the Securities and Exchange Commission sanctioned the former Board of the Nigerian Stock Exchange and External Auditors of Cadbury Nigeria Plc because the company's 2006 financial statements were misleading. In the same way, Chief Executive Officers of five banks were also sacked by the Central Bank of Nigeria because their non-performing loan was excessively on the high side. Jibrin *et al*., (2014) explained that a fundamental attribute of financial reporting is the certification by the auditor to the quality of financial statements prepared by the management. The opinion of the auditor is of economic value to users of financial statements, and it is also of great interest to most academic researchers and accounting practitioners, especially because auditing is under severe regulatory consideration (Francis 2004; Jibrin *et al*., 2014). Consequently, Accountants and the Auditors' are expected to report financial irregularities in an entity's financial statements to enhance transparency and accountability. More so, they should develop techniques for fraud detection (Jibrin *et al*., 2014). However, some researchers have argued reasonably and rightly that instead of working to meet the expectations, accounting professionals have increasingly employed their expertise to cover and promote anti-social practices (Bakre 2007; Sikka, 2008; Jibrin *et al*., 2014).

Although accounting experts and auditing firms claim to act in public interest, they have been faulted and implicated in various acts of professional misconduct and falsification and deliberate financial engineering in Nigeria (Bakre 2007; Otusanya and Lauwo 2010). Examples are the Big Four accounting firms namely: KPMG, Ernest and young, Price Water House Coopers and Akintola William and Deloitte who have been implicated in Nigeria on falsification and financial engineering scandals (Otusanya and Lauwo, 2010: 18).

2.3. Agency theory

Agency theory is a useful economic theory of accountability that helps to explain the development of the audit. The theory posits that management (agents) has more information than owners (principals). Hence the principals' capacity to determine whether or not the agent properly served their interests is adversely affected by the information asymmetry (Adeyemi and Olowookere, 2011). It is this principal-agent relationship between shareholders and management that is considered one of the prominent reasons for appointing external auditors (Aronmwan *et al*., 2013). Onyekwelu and Ugwuanyi (2014) defined the agency relationship as a contract under which one party (the principal) engages another party (the agent) to perform some services on their behalf. Hence principal delegates decision making authority to the agent. This delegation of responsibility by the principal and the resulting division of labour are aiding in promoting an efficient and productive economy. According to Jenson and Meckling (1979), a disparity exists between the agent's decisions and those decisions which would maximise the welfare of the principal. Within this principal-agent relationship, owners have interest in maximising the value of their shares, whereas managers are deeply concerned with the private consumption of firm's resources and growth (Sijpesteijin, 2011). Whenever there is a conflict of interest between the principal and the agent, obviously the agent may not operate to the benefit of the owners. Therefore, to avoid this situation, a third party (i.e. the external auditor) is often appointed to act as a mediator. (Barzegar and Salehi, 2008; Aronmwan *et al*., 2013: 2). To adequately fulfil his roles, the auditor should possess some essential skills, diligence, and care in exercising his duties, which culminated in expressing a sound opinion on the client's state of affairs. The audit opinion affects the economic decisions of users of the financial reports. The technique of collecting audit evidence for his opinion may also affect the audit quality (Aronmwan *et al*., 2013).

2.4. Information theory

Auditing is defined as an information risk-reducing activity. This definition follows from the information hypothesis that is used to explain the demand for external audits.

Under the information hypothesis, audit services are demanded to reduce the information risk to users of financial statements. Information risk is the risk that the users' decisions may be based on incorrect information. Thus, the auditors are demanded to reduce losses to wrong decisions resulting from errors or irregularities in the financial statements. Losses to an investor may also arise because of failure to disclose all the facts about a firm by company management. Auditors help in assessing whether this information asymmetry is alleviated through proper disclosure.

According to Sijpesteijn *et al*., (2011) while financial reporting is central, information principle is an alternative to monitoring principle. Information principle focuses on providing information for users' economic decisions. Investors require audited financial information for their investment decision assessing expected returns and risks. Thus investors place a high value on audit and regard it as a means of enhancing financial information quality. The audit is also considered as a means of improving financial data for internal decision making (Sijpesteijn *et al*., 2011).

2.5. Lamprey's theory of inspired confidence

In describing the Public Company Accounting Oversight Board (PCAOB)'s focus 'Restoring the Public Confidence' Carmichael (2004), Sijpesteijn *et al.*, (2011) recalled the work of professor Theodore Limpery (1876-1961) of the University of Amsterdam. Lamprey asserts that when the society loses confidence in the effectiveness of the audit process and auditor's opinion, the social usefulness of the audit is destroyed. According to Carmichael (2004), the principles of Limper's theory are especially relevant as the society has a particular need in its current environment to understand and appreciate the social significance of auditing and the implications for audit quality.

The theory of inspired confidence connects the community's need for reliability of financial information to the ability of audit techniques to meet these requirements. It also stresses the development of the needs of the society and the methods of auditing in the course of time (Limperg, 1985; Sijpesteijn, 2011: 5).

Limper described the auditor as a confidential agent whose general duty to the society arises because of the need for an expert, independent examination and independent opinion based on that examination. The duty is rooted in confidence placed on the effectiveness of the audit by the society and in the advice of the accountant (Sijpesteijn, 2011). The condition for the existence of the function is this confidence. If the auditors betray the trust, the role is destroyed too since it is no longer useful.

The auditor's role in his relationship with the users of financial statements requires the independent auditor to act as a confidential agent for society (Adeyemi and Olowookere 2011). Lamprey's framework was based on the highest possible level of satisfaction of users of financial statements about the auditor's work.

2.6. Audit litigation and audit fee

Eu-Jin and Houghton (2001) researched on "Audit Litigation and Pricing of Audit Services", with special emphasis on locality and auditor industry specialisation. Their population consists of writs issued between 1987 and 1999 alleging that audit opinion has been neglected in Australia from1987 to 1994. Audit fees of companies using litigated auditors and those of companies with non-litigated auditors were examined for each company listed from 1988 to 1995. The effects of various audit fee influences documented in previous literature were controlled. They adopted regression analysis model, the hypothesis variable (LIT) was coded '1' for each company in the test group (that is engaging an auditor against which litigation was reported in the previous year), and '0' for the control companies. The final fee regression model was therefore: FEE10; = f (Asset10 + sales10 + NAS10 – LIT), (Where '10' stands for log10). They found that the disputed auditor companies' charges are significantly lower than the fees of their counterparts that were non-litigated. It is consistent with the findings of Davis and Simon (1992) who researched whether auditors sanctioned by the U.S Securities and Exchanges Commission (SEC) experienced a decline in fees.

One big fault with Eu-jin and Houghton (2001) audit fee model is that though it recognised audit litigation, it did not incorporate litigation risks, thus should not be considered as an adequate audit fee model.

Allen *et al*., (2005) tested 'the effect of litigation on independent auditor selection'. The study examined the effects of the announcement of litigation on the likelihood of auditors being hired. Primarily the sample composed CEOs from publicly traded companies and some financial services executives. Questionnaires were handed out of the CEOs, and each subject was given a standardised scenario depicting litigation against audit firm and asked to evaluate how new information would affect a previous decision to hire a particular auditor. The mean of the responses as compared to zero in a t-test, ANOVA was employed for some of the hypotheses. They found that any litigation affects auditors' likelihood of being hired and the result suggests that an auditor should avoid, if possible, any public association with litigation.

According to Eu-Jin and Houghton (2001), where there is adverse disclosure, the auditee reaction may be a switch from the litigated auditor, presumably to receive the required level of audit quality from another auditor. While reducing events of switching away from auditors reputation are documented, Firth (1990), Wilson and Grimland (1990) and Zhivov *et al*., (1995) state that no study has reported any switch rate of 100%. However, there is no incentive to seek a fee reduction when an auditee decides to remain with a litigated auditor. It is because it may no longer have cost beneficial for fees to be retained at previous levels in the light of the decline in audit quality perceived.

3. Methodology

3.1. Introduction

The study looked at the effect of audit litigation on the pricing of audit services. It considered lawsuits, sanctions, fines and adverse publicity against the Big4 audit firms as indications of audit failures and proxies for audit litigations. It is because these variables have almost the same reputation tarnishing effect, indicating an inability to deliver quality audit, and have been found by other researchers to affect audit fee. The study also considered the impact of audit litigation risks on charges, factoring into audit fee model, net loss and negative or inadequate working capital.

The study concentrated on Big4 audit firms because they audit most of the giant listed companies on the Nigeria Stock Exchange, and any scandal implicating any of them is always louder, and grave to their image. The firms they audit are easy to pair considering that in each sector they are almost of the same size. Moreover, data about the activities of the businesses they audit are relatively available in most public places like Nigeria Stock Exchange. Firms audited by audit firms involved in litigation were matched against companies audited by other audit firms not involved in litigation, to find if there is any difference in the audit fees charged by the pairs. Firms that recorded net losses and poor working capitals for three or more consecutive years were selected to uncover the effect of audit litigation on audit fee. Questionnaires were used to investigate the impact of audit litigation on auditors' reputation.

3.2. Research design

Ex-post facto and survey were the two designs employed for this work because the study involved testing the impact of one or more (independent) variables on another (dependent), or relationship between variables, and data collected was not manipulated. The study adopted survey because the questionnaire was required to extract data for one of the hypotheses.

3.3. Population of the study/ sample size

The study's population is the listed companies audited by Big4 auditors. There are 208 companies listed on Nigeria Stock Exchange (NSE), The Big Four firms audited 98. Thus, the population is the 98 of the listed companies audited by the Big Four. (NSE Factbook, 2011/2012). Eight companies were selected from the population as sample size. These companies are PZ Cussons Plc, Guinness Nig. Plc, Fidelity Bank Plc, First Century Monumental Bank, UNIC Insurance Plc, Great Nigeria Insurance Plc, Conoil Plc and Mrs Oil Plc. The financial statements for the periods 2010 to 2012 of companies audited by AWD or PWC were paired and compared with the ones audited by KPMG or E &Y.

3.4. The sampling techniques

This work adopted convenience and judgment sampling.

3.4.1. Judgment sampling

Sample sizes were selected using the researcher's discretion considering delicate nature of the research topic. In choosing the samples, only companies with an indication of a threat of litigation risks in their financial statements (net loss, inadequate working capital among others) were considered for hypothesis 1. While only companies whose auditors were involved in litigation and that can be matched with other businesses of the same size and in the same sectors, whose auditors were litigation free were selected for hypothesis 2.

3.4.2. Convenience sampling

The study adopted convenience sampling for administering questionnaires to only top managers who have an understanding of audit reputation and how audit litigation could damage it, and who were willing to respond to the questions; more so, to pick some shareholders for the same purpose at headquarters of some banks in Enugu State.

3.5. Sample size

Eight companies were selected from the population to test the hypotheses. For the second hypothesis, to check for any fee effect of litigation, a matched-pair sample was used to match four companies audited by litigated auditors against another four firms audited by auditors not litigated. Audit fees for listed firms in

NSE engaging litigated auditors were compared with those matched enterprises for the period 2010 to 2012 (that is, businesses audited by other Big4 audit firms). The financial statements for the periods 2010 to 2012 of companies audited by AWD or PWC were paired and compared with the ones audited by KPMG or E&Y. The audit fees were extracted and compared. Therefore, 8 Companies were selected and matched considering their sectors or subsectors and net assets (see appendix 1):

As for the first hypothesis, eighty top managers and shareholders were selected from the eleven sampled companies, 40 copies of questionnaires were administered to managers; and 40 copies to shareholders found at headquarters of the following banks in Enugu state of Nigeria (visited banks are the First Bank, GTB, Fidelity Bank and Eco bank).

3.6. Statistical tools

Chi-square (X2) was adopted for hypothesis 1, t-statistics was employed in hypothesis 2, with acceptable probability significant level of 0.05, and using SPSS 17.0.

4. Data, analyses and results

Hypothesis 1, Audit litigation does not have any significant effect on auditor's reputation in Nigeria; this was tested using data contained in Table 1.

Table 1. Result of Questionnaire Administration

Question	No. Of questions given	Number Collected	Yes	No	Total
NO. 3	80	80	10	70	80
No. 4	80	80	14	66	80
No.5	80	80	12	68	80
No. 6	80	80	20	60	80
			56	**264**	**320**

***Source**: compiled by the researcher as result of questionnaires administered.*

It is the result of 80 questionnaires administered to some top managers (40) and shareholders (40) of the sampled firms. All copies of the surveys given out were collected because convenience sampling method was adopted, which enable the researchers to give the copies only to those who were ready and capable of responding immediately. That was possible because the questions were few.

Table 2. Data on companies studied (part 1)

		Auditor	Audit fee	Assets	Sales	Receivables	Current assets	Current liabilities	Net loss	Lit
			N,000	N,000	N,000	N,000	N,000	N,000	N,000	N,000
Fidelity Bank Plc	2012	**AWD**	113,000	914.300,000	198,133,000	445,500,000	560,791,000	917,762,00	NO	YES
	2011	**AWD**	84,000	740,941,000	140,096,000	256,902,000	613,452,000	603,459,000	NO	YES
	2010	**AWD**	73,000	481,615,000	112,098,000	159,561,000	404,740,000	345,437,000	NO	YES
FCMB	2012	**KPMG**	176,525	908,545,756	116,816,850	357,798,798	583,085,342	776,520,353	NO	NO
	2011	**KPMG**	129,794	601,780,418	160,796,086	319,434,207	404,411,482	484,082,907	YES	NO
	2010	**KPMG**	127,011	538,590,882	125,372,192	326,899,532	424,299,550	403,820,372	NO	NO

Table 3. Data on companies studied (part 2)

	Year	Auditor	Audit fee	Assets	Sales	Inventory	Receivables	Current assets	Current liabilities	Net loss	Lit
			N,000	N,000	N,000	N,000	N,000	N,000	N,000	N,000	N,000
Conoil Plc	2012	**AWD**	25,000	83,095,975	149,993,261	10,989,181	58,569,965	73,947,260	65,117,277	NO	YES
	2011	**AWD**	21.000	61,841,670	157,512,072	7,351,939	27,965,539	53,874,674	42,862,554	NO	YES
	2010	**AWD**	19,000	41,489,945	102,878,494	6,871,787	16,794,921	33,819,888	24,120,507	NO	YES
Mrs. Oil Nig. Plc	2012	**KPMG**	24,914	75,595,688	139,727,349	4,331,733	18,564,945	33,197,380	30,084,663	NO	NO
	2011	**KPMG**	17,114	67,485,060	141,490,715	8,366,153	13,564,382	49,401,824	45,749,756	NO	NO
	2010	**KPMG**	12,500	40,997,973	114,781,925	8,637,715	10,637,229	22,418,681	19,558,551	NO	NO

Table 4. Data on companies studied (part 3)

	Year	Auditor	Audit fee	Assets	Sales	Inventory	Receivables	Current assets	Current liabilities	Net loss	Lit
			N,000	N,000	N,000	N,000	N,000	N,000	N,000	N,000	N,000
UNIC Insurance Plc	2012	**AWD**	15,000	6,024,100	3 18,900	1,979	626,833	2,090,348	3,237,694	YES	YES
	2011	**AWD**	15,000	5,948,487	364,055	3,992	1,594,943	1,649,550	3,498,366	NO	YES
	2010	**AWD**	15,000	6,895,357	251,418	2,161	1421,495	1,514,177	4,090,617	YES	YES
Great Nig. Insurance Plc	2012	**KPMG**	20,000	8,432,402	782,195	2,128	930,104	2,670,168	5,693,121	NO	NO
	2011	**KPMG**	15,00	8,257,396	540,883	4,722	488,749	2,370,968	5,370,968	NO	NO
	2010	**KPMG**	13,000	8,765,433	699,645	2,722	487,195	1,631,298	4,484,658	YES	NO

Table 2. Data on companies studied (part 4)

	Year	Auditor	Audit fee	Assets	Sales	Inventory	Receivables	Current assets	Current liabilities	Net loss	Lit
			N,000	N,000	N,000	N,000	N,000	N,000	N,000	N,000	
PZ Cussin	2012	**PWC**	21, 156	94,406,797	112,154,601	22,481,616	14,512,241	40,046,450	17,112,374	NO	YES
	2011	**PWC**	23,155	88,926,529	115,877,984	17,481,616	14,851,931	43,891,587	22,087,259	NO	YES
	2010	**PWC**	21,655	78,968,513	112,667,910	15,353,525	8,506,607	34,230,920	15,268,401	NO	YES
Guinness Nig. Plc	2012	**KPMG**	29,236	102,534,172	126,288,184	21,998,519	10,852,303	37,622,976	38,996,801	NO	NO
	2011	**KPMG**	26,578	92,175,032	123663,125	17,381,132	18,133,997	44,369,719	36,535,849	NO	NO
	2010	**KPMG**	24,162	82,858,876	109,366,975	16,152,706	13,256,299	42,489,725	34,810,377	NO	NO

HYPOTHESIS 1- H_1: Audit litigation does not have any significant effect on auditor's reputation in Nigeria. Data for this was taken from Table 1.

Table 6. Case Processing Summary

	Cases					
	Valid		Missing		Total	
	N	Percent	N	Percent	N	Percent
X * Y	320	100.0%	0	.0%	320	100.0%

Table 7. X * Y Cross-tabulation

			Y		Total
			0	1	
X	0	Count	10	70	80
		Expected Count	14.0	66.0	80.0
		% within X	12.5%	87.5%	100.0%
		% within Y	17.9%	26.5%	25.0%
		% of Total	3.1%	21.9%	25.0%
	1	Count	14	66	80
		Expected Count	14.0	66.0	80.0
		% within X	17.5%	82.5%	100.0%
		% within Y	25.0%	25.0%	25.0%
		% of Total	4.4%	20.6%	25.0%
	2	Count	12	68	80
		Expected Count	14.0	66.0	80.0
		% within X	15.0%	85.0%	100.0%
		% within Y	21.4%	25.8%	25.0%
		% of Total	3.8%	21.3%	25.0%
	3	Count	20	60	80
		Expected Count	14.0	66.0	80.0
		% within X	25.0%	75.0%	100.0%
		% within Y	35.7%	22.7%	25.0%
		% of Total	6.3%	18.8%	25.0%
Total		Count	56	264	320
		Expected Count	56.0	264.0	320.0
		% within X	17.5%	82.5%	100.0%
		% within Y	100.0%	100.0%	100.0%
		% of Total	17.5%	82.5%	100.0%

Table 8. Chi-Square Tests

	Value	Df	Asymp. Sig. (2-sided)	Exact Sig. (2-sided)	Exact Sig. (1-sided)	Point Probability
Pearson Chi-Square	4.848[a]	3	.183	.182		
Likelihood Ratio	4.698	3	.195	.203		
Fisher's Exact Test	4.607			.203		
Linear-by-Linear Association	3.383[b]	1	.066	.076	**.038**	.010
N of Valid Cases	320					

a. 0 cells (.0%) have expected count less than 5. The minimum expected count is 14.00.

b. The standardised statistic is -1.839.

Table 9. Symmetric Measures

		Value	Approx. Sig.	Exact Sig.
Nominal by Nominal	Phi	.123	.183	.182
	Cramer's V	.123	.183	.182
	Contingency Coefficient	.122	.183	.182
N of Valid Cases		320		

Based on the result from Pearson Chi-Square χ2 (1) = 4.848, $p < .05$, the test has a chi-square p-value of 0.038, at 3 degrees of freedom [DF (4-1) = 3], which is significant at 0.5, there is sufficient statistical evidence to conclude that audit litigation has considerable effect on auditor's reputation in Nigeria. Therefore, the null hypothesis is rejected.

HYPOTHESIS II- H_2: Audit litigation does not have a significant impact on pricing of audit services in Nigeria.

t-test pairs = litigated firms with no litigated firms (paired)/criteria=ci (.9500) /missing=analysis

Table 10. Paired samples statistics

		Mean	N	Std. Deviation	Std. Error Mean
Pair	Litigated firms	148655.33	3	23243.827	13419.830
	Non litigated firms	205278.00	3	39756.162	22953.231

First, the table tells us the mean difference between scores. (It is the difference between the mean scores of each condition: 148655.33 – 205278.00 =-56622.667). The table also reveals the standard deviation of the differences between the means and more critical the standard error of the differences between participants' scores in each condition.

Table 11. Paired samples correlations

	N	Correlation	Sig.
Litigated firms & non-litigated firms	3	.986	.107

For these data the experimental conditions yield a large correlation coefficient (r = .986) and significantly correlated because p > .05

Table 12. Paired samples test

		Paired Differences					t	df	Sig. (2-tailed)
		Mean	Std. Deviation	Std. Error Mean	95% Confidence Interval of the Difference				
					Lower	Upper			
pair	Litigated firms Less non litigated firms	-56622.667	17283.028	9978.361	-99556.088	-13689.245	-5.675	2	.030

Test Results: t (1) = -5.675, p < .030

Due to the means of the two samples and the direction of the t-value, it can be concluded that audit litigation statistically and significant impact on audit pricing, (p < .030). Hence, the null hypothesis which states that audit litigation does not have a significant impact on pricing of audit services in Nigeria and was rejected.

The two-tailed probability for the audit pricing data is very low (p = .030), and in fact, it tells us that there is only a 3 % chance that a value of t could happen if the null hypothesis were correct. We accept a p < .05 as statistically meaningful; therefore, this t is significant because .030 <.05. The fact that the t-value is a negative number tells us that the first condition (the litigated firms) had a smaller mean than the second (the non-litigated companies) and so the period led to more significant audit pricing than the litigation period.

Hence, we can conclude that firms audited by litigated auditors pay lower audit fees than companies audited by non-litigated auditors, t (1) = −5.675, p < .05. Here other factors that influence audit fees other than audit litigation were ignored in the test, but they were captured in Model introduced in regressing hypothesis 1. Therefore, the difference in audit fees paid by the two groups could be contributed by those other factors.

5. Discussions

Hypothesis 1: Audit litigation does not have any significant effect on auditor's reputation in Nigeria.

Based on the result from Pearson Chi-Square $\chi2$ (1) = 4.848, $p < .05$, the test has a chi-square p-value of 0.038, at 3 degrees of freedom [DF (4-1) = 3], which is significant at 0.5, there is sufficient statistical evidence to conclude that audit litigation has a substantial effect on auditor's reputation in Nigeria. Therefore, the null hypothesis is rejected. The study concludes that audit litigation has a significant impact on auditors' reputation. When an auditor faces charges for audit failure, sanctioned or fined by a legal or professional body for failure to deliver quality audit or he faces adverse publicity, he is likely to lose his current clients and find it difficult to attract new ones. If he can retain some of the current clients, he might do so by reducing audit fees to compensate for the lost reputation. This result affirms the Reputation Rationale (Product Differentiation). The theory claims that the bigger audit firms have greater reputation earned from a history of quality audit, which attracts fee premium that accounts for the higher fees they charge. The result also lends credence to Lamprey's theory of inspired confidence, information theory and assurance theory amongst others. It also corroborates with the finding of Allen *et al*., (2005) who tested 'The Effect of Litigation on Independent Auditor Selection'. They found that any litigation affects auditors' likelihood of being hired. Thus the result suggests that an auditor should avoid, if possible any public association with litigation which erodes his reputation and ability to negotiate and attract handsome fees.

Hypothesis 2: Audit litigation does not have a significant impact on pricing of audit services in Nigeria.

Due to the means of the two samples and the direction of the t-value, it was concluded that audit litigation statistically and significantly impacts on audit pricing, ($p < .030$). Hence, the null hypothesis which states that audit litigation does not have a significant effect on pricing of audit services in Nigeria is at this moment rejected. The two-tailed probability for the audit pricing data is very low ($p = .030$), and in fact, it tells us that there is only a 3 % chance that a value of t could happen if the null hypothesis were correct. We accept a $p < .05$ as statistically meaningful; therefore, this t is significant because .030 <.05. The fact that the t-value is a negative number tells us that the first condition (the litigated firms) had a smaller mean than the second (the non-litigated companies) and so the period led to more significant audit pricing than the litigation period. The result indicates that audit litigation has a significant but adverse effect on pricing of audit services (audit fees). Audit litigation reduces the ability of auditors to negotiate and attract handsome fees. It is because they face the task of convincing their existing customers to stay and the more laborious task of drawing new ones. The result has the backing of the findings of Eu-jin and Houghton (2000) who investigated, 'Audit litigation and pricing of audit and pricing of audit services'. They found that the litigated audit firms' fees are significantly lower than those of their matched pair non-litigated auditor counterparts.

6. Conclusion

We, thus conclude by stating that factoring audit litigation into audit fee models is necessary considering their significant effects on auditors' reputation and pricing of audit services. Audit clients expect quality audit and are ready for high fee premium to have it. Poor audit affects the clients' financial reports, and they will likely take action to protect their image and recoup their losses. Audit litigation reduces auditors' reputation, affects their ability to retain the existing clients, attract new ones, and attract high fees. It affects the bargaining power of an audit firm and attracts low pricing of audit services. It further reveals the necessity of including audit litigation (mark by legal actions, fines, sanction and adverse publicity) in audit fee model.

The study, therefore, recommended that: auditors should accept only engagements that they can produce a quality audit. Auditors should consider all the factors, which could pose threats to audit failure, plan on how to reduce or eliminate such risks. Auditors should decline to accept any engagements the threats of audit failure of which they cannot curb. Auditors should avoid any reputation tarnishing event to protect their bargaining power, retain their current clients and be able to attract new clients. Audit clients should consider the effect of maintaining or hiring a litigated auditor on their reputations and market price of their financial instruments. The Government of Nigeria should have enough legislation in place to regulate the activities of auditors, protect investing public and the economy as a whole from the menace of audit failure and its offshoot, business failure. Audit fee models should include variables for audit litigation to be complete and comprehensive, and to depict the impact of both on audit pricing. Professional accounting bodies should have proper supervision of the activities of their members to avoid actions that will result in audit litigation and to protect investors from the consequent substantial losses associated with it. In return justify the faith reposed on them by the capital market participants.

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