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The assessment of auditors' independence on financial reporting; Nigerian experience

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Abstract
The study was carried out in order to examine the assessment of auditors' independence on financial reporting; Nigerian experience. The study aimed at evaluating and assessing the interaction between audit quality and corporate financial reporting in Nigeria. Hence the study is a movement towards improving the quality of audit practice in Nigeria. In conducting this study, primary data were used, out of which one hundred and fifty (150) copies of questionnaire were properly filed and returned. This study captured the opinion of respondent of professional accountants and corporate entities in Lagos State, Nigeria. The data collected were analyzed using the frequency distribution table and percentage. The study questionnaire gathered was used to test the research hypothesis through the use of Analysis of variance. The findings revealed that there is a significant relationship between audit quality and the quality of financial reporting with recommendations to four key stakeholders such as Management, Government, Auditors and Higher Institution of Learning.

Keywords: auditors' independence, financial reporting, financial information, audit firms, decision making

1. Introduction

The main objective of financial reporting is to provide high quality financial information about economic entities that is useful for economic decision making. According to International Accounting Standard Board (IASB), (2008), high quality financial reporting is critical to investors and other stakeholders in making investment, credit and similar decision. An important variable of financial reporting that is usually used as a yardstick of financial reporting quality is accounting earnings, as it is reported in the published financial report of firms, it expected to provide a timely and reliable input to potential investors, shareholders, creditors, employees, management, financial analysts, regulators and other stakeholders for efficient economic decisions. In Nigeria, there have been various audit failures, some prompting the rehashing of figures in the financial statement. For instance, Lever Brothers and Cadbury Despite the fact that, it has not been demonstrated by any investigation that these audit failures were because of impairment of auditor's independence it may be implied that it is a contributing factor (Adelaja, 2009). The auditor gives the organization credibility as to the financial heartiness, as he expresses a professional opinion on whether or not the financial statement shows true and fair view and are properly prepared in accordance with the relevant statutory regulatory such as the Companies and Allied Matter Act 1990 (as amended) and other legislations. (Felix 2015) [3]. The issue of auditor's independence has gotten a great number of attentions from regulators, professionals and scholars around the world lately due to highly rate of audit failure in publicity (Hope and Langli 2009).

2. Literature review

2.1 Auditor independence

Audit Independence is explained as an auditor's unbiased mental attitude in making decisions throughout the audit and financial reporting process. Independence refers to the quality of being free from influence, persuasion or bias, the absence of which will greatly impair the value of the audit service and the audit report. An auditor's lack of independence increases the possibility of being perceived as not being objective. The impaired independence results in poor audit quality and allows for greater earnings management and lower earnings quality (Okolie, 2013)

Ikharo C.O. (2015) opines that "Auditor's independence implies the ability of an auditor to perform his audit work in accordance to his judgment, free from any undue influence and without being biased". Independence is an attitude of mind characterized by integrity and objectivity. An auditor should not only be independent but he should also be seen as being independent. An auditor is expected to avoid undue influence.

2.2 Audit committees

An audit committee is a selected number of members of a company's board of directors whose responsibilities include helping the auditors remain independent of management. For that reason, there is much support to suggest a positive relationship between audit committees and auditor independence. According to SOX section 301, the audit committee carries out its responsibility over the financial reporting process by Appointing, overseeing and compensating the independent and compensating the independent auditor; establishing procedures for handling complaints about accounting, auditing and internal control Establishing procedures for the submission of concerns about questionable accounting and auditing matters.

2.3 Non-audit services

Non-audit services are defined as all services provided by an auditor that are not considered as an audit. Such services may be Management Advisory Services (MAS) and compliance related services (tax and accounting services). These services can be provided by the incumbent audit firm or another audit firm. Non-audit services constitute the source of non-audit income.

2.4 Determinants of financial reporting quality

There are a number of factors that determines the quality of financial reporting as used by previous studies that examined the factors that affect financial reporting quality. One of the most arguable factors is the monitoring mechanism of the company, Famaand Jensen (2008) have argued that the credibility and transparency of financial reporting of a company depends on the effectiveness of the monitoring mechanism of the company itself. This has led researchers to examine the effects of several monitoring mechanisms such as board of directors, audit committees, internal audit and external audit to the financial reporting quality. Since the board of directors receives its authority for internal control and other decisions from stockholders of corporations. The highest internal control and monitoring mechanism is the board of directors. Based on this fact, researchers have argued that board of directors has an effect on the quality of financial reporting. It was emphasized that, to perform effectively as a monitoring mechanism, the board of directors should be structured properly by considering its independency and optimum number of members.

2.5 Threats to the integrity and independence of an auditor

Sharma (2006) and Sharma and Sidhu (2001), cited in Felix (2015) [3] argue that for an effective list of threats to auditor independence, there is a need to study the opinion the auditor ought to have given relative to the actual opinion given. If it is determined that the auditor ought to have given a qualified audit opinion, but had given a clean opinion; the reasons for the deviation could be attributed to independence impairment after controlling for other explanations. According to ICAN (1999), a number of threats to independence were identified. These threats include: self-interest; self-review; advocacy, familiarity, and intimidation. A brief outline of the five types of threats which may occur as a result of Non-audit services (Felix, 2015) [3] are:

2.5.1 The self-interest threat

An auditor’s independence may be threatened if a firm or a member of the audit team benefits from a financial interest in an audit client. This could arise, for example, from a direct or indirect interest in a client; or from a fear of losing the client.

2.5.2 The Self-Review Threat

This relates to the difficulty of maintaining objectivity when conducting a self-review procedure. This can arise when any product or judgment from a previous audit (or non-audit) assignment needs to be challenged, or re-evaluated in reaching the current audit conclusions; or when a member of the audit team has previously been a director or officer of the audit client, or was employed in any position likely to affect the subject matter of the audit engagement.

2.5.3 The Advocacy Threat

This occurs when the auditor promotes, or is perceived to promote, a client’s opinion to a point where people may believe that objectivity is getting compromised. For instance, advocacy in any sharpened form is likely to threaten an auditor’s independence, and appears to be incompatible with the particular objectivity required by the audit-reporting role.

2.5.4 The Familiarity to Trust Threat

By virtue of the close relationship with an audit client, its directors, officers and employees, there is a risk that the auditor may be influenced by the client’s business ambience. This caution against over-familiarity must also include the influence of a client’s personality and other personal qualities.

2.5.5 Intimidation Threats

This occurs when auditors are deterred from accounting objectively with an adequate degree of professional skepticism because of threats of replacement. According to CIMA (2002), independence may be compromised when preparing accounting records and financial statements. There is an obvious self-review threat and auditors must not make ‘management decisions’. For audit clients that are not listed entities, the firm may provide an audit client with accounting and book-keeping services of a ‘routine or mechanical nature’.

2.6 The size of the auditor’s remuneration

Large size of audit fees is normally associated with a higher risk of losing the auditor’s independence. The IFAC’s Code of ethics for professional Accountants suggests that client size (measured from size of fees) could raise doubts as to independence. In Malaysia, the MIS By Law (Section B-1.98 on Professional Independence) has emphasized that “if the total fees (arising from assurance and non-assurance services) generated by one assurance client or its related entities exceed 15% of the firm’s total fees in each year over two consecutive financial periods, financial dependency shall be considered to exist, in which case, a self-interest threat to independence is created. In such event, the only course of action is to refuse to perform or withdraw from the assurance engagement.”

2.7 Theoretical review

2.7.1 The entity theory

Kabiru and Abdullahi (2014), the business firm is considered to have a separate existence, to the extent of having a personality of its own. The entity theory based on the equation that Assets are equal to Equity plus liabilities suggests that the valuation of the rights of the creditors can be determined independently of other valuations if the firm is solvent, while the rights of the stockholders are measured by the valuation of assets originally invested plus the valuation of reinvested earnings and subsequent revaluations. The rights of the stockholders to receive dividends and share in net assets upon liquidation are, however, rights as equity holders, rather than as owners of specific assets. The liabilities are specific obligations of the firm, and the assets represent the rights of the firm to receive specific goods and services or other benefits.

2.7.2 Stakeholder Theory
With regard to financial reporting, stakeholder theory maintained that organizations have to account for their stewardship over the resources entrusted to them to various stakeholders including among others debenture holders and members of the public. This therefore suggests that the responsibility of directors is to serve various interest groups and individuals. However, the theory was developed to address the shortcomings of the agency theory. The agency theory was criticize for prioritizing the interest of shareholders above the general interest of other stakeholders, such as employees, the government and the society in general (Charron, 2007, cited in Barde, 2009, by Umaru 2014). This theory argued that the firm is a social person and therefore is responsible and accountable not only to the shareholders but to numerous other stakeholders. In line with this, firms are expected to disclose more information in financial statements in order to satisfy the interest of various stakeholder groups (not only shareholders' interest).

2.7.3 Policeman Theory
According to the Policeman Theory, the auditor's job is to focus on the arithmetical accuracy of financial statements and on prevention and detection of fraud. The Lending Credibility Theory states that the audited financial statements are used by management to enhance the stakeholder's faith in management's stewardship (Hayes, Knechel and Wong 2012, cited in Felix 2015) [3]. The theory that is most often used in research contexts and incorporates parts of the Policemen Theory and Lending Credibility Theory is the Agency Theory because the Agency Theory is the most important theory explaining the demand for audit.

2.7.4 Theoretical Framework
This study is anchored on Agency Theory. Agency Theory is built on the premises that there is an agency relationship wherein the principal delegates work to the agent. As a result, there evolves risk sharing and conflict of interest between the two parties. It is the belief that the agent will be driven by self-interest rather than the desire to maximize the profits for the principal. The theory describes the conflicts that arise as a result of the separation of ownership and control. There is considerable information asymmetry between the agent and the principal. Auditors serve to reduce agency costs by reducing this information asymmetry and consequently contractual conflict.

3. Methodology
Survey research method was used to gather information from respondents concerning their opinions on the assessment of auditor's independence on financial Business reporting. It is a design adopted to collect data from a defined population in order to describe the present condition of the population using the prescribed variables. In view of the foregoing, the descriptive and survey design approach will be used for this study and conclusion will be drawn based on the data generated by the survey research instrument. The population of the study covers professional accountants in Lagos State who work at different sector of entities such as Audit firms and corporate entities within Lagos with the view of considering estimated population of Four hundred and Forty-five (445). The respondents will be sampled using simple random sampling technique. The sample size is one hundred and fifty (150) professional accountants working in audit firms and corporate entities in Lagos State. The sample units selected will be based on the respondents' readiness and willingness to assist in filling out the data collection instrument.

4. Results
4.1 Descriptive analysis
The table below provides descriptive statistics of both explained and explanatory variables of the assessment of auditors' independence on financial reporting, Nigerian experience.

4.2 Frequency distribution of socio economic data of respondents

Table 1: Respondents' Demographic Data

		Count	Percentage %
Respondents' Gender	Male	85	63.0%
	Female	50	37.0%
	Total	135	100.0%
Respondents' Age	20-30years	21	15.6%
	31-40years	70	51.9%
	41-50years	42	31.1%
	55Years and above	2	1.5%
	Total	135	100.0%
Respondents' Education	OND/NCE	5	3.7%
	HND/B.SC/BA	41	30.4%
	PGD/MBA/MSC	37	27.4%
	Professionals	47	34.8%
	Others	5	3.7%
	Total	135	100.0%

***Source*:** Field Survey, 2017

Table 1 shows respondents' demographic data. The numbers of male and female respondents' were 85 and 50 respectively. This constitute 63.0% and 37.0% respectively.
The results further revealed that 15.6% of respondents' were between 20- 30 years, 51.9% were between 31-40 years, and 31.1% of the respondents were between 41-50 years old while only 1.5% of respondents' were 55 years and above. 3.7% of respondents' were OND/NCE holder, 30.4% of the respondents' were BSC/HND/BA holder, 27.4% of the respondents' were PGD/MBA/MSC holder, 34.8% of the respondents were Professionals while only 3.5% represents respondents with other qualifications.

4.3 Test of Hypothesis
Frequency Distribution of Respondents Opinion according to Research Questions
To what extent will audit firm independence affect the quality of financial reporting of quoted financial institutions in Nigeria?

Table 2: Respondents' opinion on the extent of audit firm independence on the quality of financial reporting of quoted financial institutions in Nigeria?

		SDA	DA	U	A	SA	Total
Auditors independence significantly affect the quality of financial reporting	F	2	7	6	32	88	135
	%	1.5%	5.2%	4.4%	23.7%	65.2%	100.%
The close relationship of an auditor to his client imposes a risk on his independence in expressing audit opinion on the financial report without being bias.	F	2	12	11	53	57	135
	%	1.5%	8.9%	8.1%	39.3%	42.2%	100.0%
When the auditor promotes his client opinion the objectivity is been compromised such could lead to impairment on his independence.	F	3	16	9	42	65	135
	%	2.2%	11.9%	6.7%	31.1%	48.1%	100.0%
Auditor independence may not be threaten when a member of the audit team benefit financially from his client	F	27	27	9	53	19	135
	%	20.0%	20.0%	6.7%	39.3%	14.1%	100.0%
The audit committee promotes the auditor's independence by acting as an intermediary between the management and independent auditor.	F	4	6	25	47	53	135
	%	3.0%	4.4%	18.5%	34.8%	39.3%	100.0%

***Source*:** Field Survey, 2017

4.4 Interpretation of results

Respondents' opinion from table 2 revealed that; 88.9% of respondents agreed that Auditors independence significantly affect the quality of financial reporting, 6.7% disagreed with the assertion. This indicates that Auditors independence significantly affect the quality of financial reporting

The results further revealed that 81.5% of respondents agreed that close relationship of an auditor to his client imposes a risk on his independence in expressing audit opinion on the financial report without being bias but 10.4% disagreed with the assertion. This implies that close relationship of an auditor to his client imposes a risk on his independence in expressing audit opinion on the financial report without being bias.

It was discovered that 79.2% of respondents agreed that when the auditor promotes his client opinion the objectivity is been compromised such could lead to impairment on his independence while 14.1% disagreed with the assertion. This further revealed that when the auditor promotes his client opinion the objectivity is been compromised such could lead to impairment on his independence.

Respondent opinion showed that 53.4% of respondents agreed that auditor's independence may not be threaten when a member of the audit team benefit financially from his client, 6.7% were undecided while 40% disagreed with the assertion. This shows that auditor independence may not be threaten when a member of the audit team benefit financially from his client.

Also 74.1% of respondents agreed that the audit committee promotes the auditor's independence by acting as an intermediary between the management and independent auditor while 7.4% disagreed with the assertion. This further affirms that the audit committee promotes the auditor's independence by acting as an intermediary between the management and independent auditor

Hypothesis

H_0: The audit firm independence does not contribute significantly to the quality of financial reporting in Nigeria.

Decision Rule: If $p \geq \alpha$, Accept H_o. Else reject H_o.

Table 3: Regression and Coefficient of Determination for audit firm independence and quality of financial reporting in Nigeria

Model Summary				
Model	R	R Square	Adjusted R Square	Std. Error of the Estimate
1	.294[a]	.086	.079	1.215
a. Predictors: (Constant), audit firm independence				

Table 3 shows the coefficient of determination, a measure of the general significance of the explanatory variables. The value of R-square implies that about 86.0% variation in quality of financial reporting in Nigeria are explained by the variation in explanatory variables of audit firm independence.

Table 4: Analysis of Variance

ANOVA[a]						
Model		Sum of Squares	Df	Mean Square	F	Sig.
1	Regression	18.378	1	18.378	12.445	.001[b]
	Residual	194.935	132	1.477		
	Total	213.313	133			

a. Dependent Variable: quality of financial reporting in Nigeria

b. Predictors: (Constant), audit firm independence.

Table 4 shows a p-value of 0.01. Since the p-value is less than the value of α (0.05), therefore H_1 should be accepted. This implies that audit firm independence contribute significantly to the quality of financial reporting in Nigeria.

5. Summary and Conclusion

5.1 Summary

This study examined the assessment of the auditor's independence on financial reporting: Nigerian experience. Specifically, the study assesses the adequacy of professional and regulatory stipulation on audit independence in Nigeria. Investigate the relationship between auditor's independence and financial reporting quality.

The objectives of the research methodology were achieved with the use of primary data thus using questionnaire as the major instrument of this research work. The populations of the study are professional accountants in Lagos State who work at different sector of entities such as Audit firms and corporate entities within Lagos. The sample size for this research work was made up of one hundred and fifty (150) professional accountants working in audit firms and corporate entities in Lagos State.

5.2 Conclusion

From the finding of the study, it was revealed that the audit firm independence contributes significantly to the quality of financial reporting in Nigeria and that non-audit services have a significant effect on the quality of financial reporting in Nigeria.

This study indicates that Auditors independence significantly affect the quality of financial reporting and implies that close relationship of an auditor to his client imposes a risk on his independence in expressing audit opinion on the financial report without being bias.

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