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Perceptions of Auditors' Independence in Nigeria

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ABSTRACT

It has been asserted that the value of an auditor's report or auditing services depends on the fundamental assumption that auditors are independent of their clients. This means that if the users of financial statements do not believe that an auditor is independent of a client, they will have little confidence in the auditor's opinion. There have been considerable studies on this issue. However, recent events like the collapse of Enron in the United States of America, the Africa Petroleum saga in Nigeria and Cadbury Nigeria PLC have opened fresh discussions on the vexed issue of auditors' independence. This study therefore examined the issue of auditors' independence from the perspective of various stakeholders. It presents the results from a survey of a sample of auditors, bank loan executives and financial analysts. The data were subjected to the one-way analysis of variance (ANOVA). The study found that Nigerian auditors are low on the auditor's independence scale due to a number of factors. The study also made recommendations to mitigate the situation.

Keywords: Auditor, Independence, Audit Client, Financial Statements.

INTRODUCTION

In modem day economies, corporations (companies) play a dominant role. There are constant interactions between corporations, which are regarded as separate legal entities and other organizations and individuals. Periodically, these corporations publish financial statements which professional auditors are required to certify and express opinion on their fairness and truthfulness. It has been asserted that the value of an auditor's report or auditing services depends upon the fundamental assumption that auditors are independent of their clients (Shockley, 1981). This means that if the users of financial statements do not believe that an auditor is independent of a client, they will have little confidence in the auditor's opinion (SEC, 2002: 2). According to Okojie(2006:2) "the concept of audit and the concept of independence are the two sides of the same coin. The auditor who has lost his independence has lost his reason for existence: he has become dependent",

Independence in fact or actual independence is not measurable. Therefore it is usually the appearance of independence that is important. Since the appearance of independence is a subjective phenomenon, perception of auditors' independence is likely to vary from place to place. There has been much empirical research on auditor's independence. However, there is still need for further research on the issue because the ultimate goal of making the auditor truly independence has not been realized.

As stated above the certification of financial statements by external auditors is one of the ways of assuring the public that such financial reports are true and fair. One of the pillars of the credibility of the auditor is the fact of his independence of the audit client. However, recent changes in the accounting profession and the type of services that auditors are providing to their audit clients have brought about concerns about their independence. The research questions which are addressed in this study are: (i) Are Nigerian Auditors' independent of their audit clients? (ii) What is the relationship between the credibility of the auditor's work/services and the perception of his independence? (iii) What is the perceived relationship between the size of an audit firm and the auditor's independence? (iv) Does the competition among auditors for audit jobs affect auditors' independence? (v) Do the legal and professional provisions/regulations adequately guarantee auditors' independence in Nigeria? (vi) Does the provision of non-audit service by auditors affect their independence?

To provide answers to the research questions, the following hypotheses relating to various aspects of auditors' independence in Nigeria were tested.

H_1: The Nigerian External Auditor is not independent of the audit client.

H_2: The credibility of the auditor's works/services is positively correlated with the perception of the auditor's independence.

H_3: There is a positive correlation between the size of the audit firm and the auditor's independence.

H_4: The competition for audit clients by audit firms in Nigeria adversely affects auditors' independence.

H_5: The legal and professional provisions/regulations adequately guarantee auditors' independence in Nigeria.

increased due to removal of solicitation restriction in many countries. This can be reflected in the burden and pressures faced by auditors (Barlett, 1993); tender threats by auditors (Moizer,1994) and competitive pricing by auditors (ICAEW, 1995).

According to Tahinakis and Nicolaou (1999) the provision of non-audit services(NAS) is inconsistent with the auditing profession. An auditor providing both audit and consulting services may become not only an advocate of the client, but also develop too close relationship with the management making it difficult to remain independent. As a result, he/she does not give appreciable emphasis and effort to perform the audit work necessary to support his/her opinion (Shockley,1981; Pany and Rechkers.1988). According to Beatie, Brandt and Fearnce (1999), the provision of NAS by incumbent auditors is favoured by both the auditors and audited company mainly because of its efficiency arising from knowledge spillover effects. No direct evidence that NAS provision by auditors impairs auditor's independence has been uncovered by various congressional and professional reports (U.S. Senate, 1978 and AICPA 1979). This does not, however preclude an impact upon perceived independence (Beattie, Brandt And Fearnce, 1999).

Regulatory factors affecting auditor's independence concern both accounting and auditing. It is argued that independence is threatened where all auditors do not agree on the preferred accounting treatment due to flexibility of accounting standards, (Knapp1985; Magee And Tseng, 1990). Key aspects where regulation is argued to promote independence is the existence of unlimited legal liabilities of auditors(Farmer et al,1987:5) strong enforcement of standards, effective discipline of companies, auditors control over the appointment and remuneration of auditors, and the existence of audit committees. In addition to these principal factors, a wide variety of factors have been discussed. Some of the other factors usually mentioned are long periods of tenure (Mautz and Sharaf, 1961; Beck et al, 1988); the auditees' financial condition (Knapp, 1985);unpaid fees (Stamp and Moonitz, 1978); existence of audit committee and disclosure of non-audit fees (Teoh and Lim, 1996). The number, classification and combination of the factors affecting the auditors independence is not exhaustive. The European commission identified five threats or risks which can compromise the statutory auditors' independence: self interest threat; self review threat; advocacy threat; familiarity threat, and intimidation (European commission, 2002). According to the European Commission, specific circumstances in which threats to independence can arise include financial interests, business relationships, employment with the client, management or supervisory role with the audit client, personal relationship and the provision of non - audit services.

In Nigeria, the various possible threats to the auditor's independence are identified in the Rules of Professional Conduct for Members by the Institute of Chartered Accountants of Nigeria (ICAN, 1995) The following threats to objectivity and independence were identified: self interest threat; self review threat; the advocacy threat; the familiarity or trust threat; the information threat; undue dependence on audit client; loans from a client; the intimidation threat; undue dependence on audit client; loans from a client; guarantees; overdue fees; hospitality or other benefits; actual or threatened litigation; participation in the affairs of a client; principal or senior employer joining client; mutual business interest ; beneficial interest in shares and other investments; provision of other services to audit clients.

THE PUSH FOR AUDITORS' INDEPENDENCE

Various countries of the world had over time made conscious attempts to ensure the independence of the auditor. In Europe, a system of audit regulation and pro-active monitoring was introduced in 1991, through the European commission (EC) Directive concerning the mutual recognition of auditors. Previously an individual holding a recognized accounting qualification (and practicing certificate awarded by their professional body) was eligible to undertake company audits and was subject to the disciplinary procedure of their professional body under delegated authority from the Department Of Trade And Industry (DTI). A new audit regulation has been developed by the DTI in conjunction with the professional bodies, which inter alia, established a strong framework for auditors' independence. The new regime requires auditors to be licensed. Regulatory breaches render the audit firm liable to professional disciplinary processes and the withdrawal of registration. Not satisfied with the reforms, UK SEC made specific proposal for auditors' independence vide the Auditors' independence rule (Securities Act Release N0.33-7870 of 2000 (see Palmrose and Saud, 2001).According to Palmrose and Saud (2001), the SEC's proposed rule represented an important inflection point in the long- standing debate over the provision of non-audit services to audit clients. Following the fall of Enron in the U.S, the Sarbanes Oxiey Act of 2002 was enacted to bring sanity to corporate government in U.S. quoted firms. The Act made far reaching provisions that were among others intended to make the Auditor more independent. In Nigeria various attempts have been made to make the auditor truly independent. A new corporate Governance code was enacted by the Securities and Exchange Commission effective from April 3, 2003 (SEC, 2003). The code acknowledged the dangers posed to auditors' independence by the provision of non- adult services to audit clients and consequently mandated public companies to disclose the amount of fees paid to auditors in any year for auditing and non auditing services. In the financial sector, the Central Bank Of Nigeria, enacted a code of corporate Governance for Banks (CBN, 2006).

RESEARCH METHODOLOGY

The research design is a structured survey of a stratified random sample of 120 respondents in Edo State. The research is about the perception of Auditors[7] in Nigeria but due to resource constraints, the study was limited to Edo state. The respondents were drawn from among three groups: (a)Registered Auditors, (b)Bank Loan Executives in loan departments, and (c)Financial Analysts. The registered Auditors were drawn from the list of Auditors in practice as contained in the 1998 Membership Year Book of the Institute of Chartered Accountants of Nigeria and lecturers in Accounting and Finance. The classification as financial analysts is not based entirely on whether they were actually in practice as financial analysts but rather on the fact of the respondents qualification to so practice. The respondents were surveyed through questionnaires.

The Five Points Likert type scale was used in the design of questionnaire. The Likert type scale has been one of the most widely and successfully used techniques to measure attitudes (Donald, et al 1985). See also Likert (1932). The scale was constructed by assembling a number of statements about auditors' independence in Nigeria. The respondents were asked to indicate whether they strongly agree, agree, undecided, disagree or strongly disagree with each of the series of statements. The questionnaire consists of two parts; part I contains questions on information about the respondents for the purpose of respondents classification and part 11 consist of questions on issues of Auditor's, independence in Nigeria.

The method used in data analysis include the following: (i) Actual respondent's analysis, (ii) The analysis of variance (ANOVA); and (iii) Percentage analysis. The actual response analysis shows the analysis of the actual responses obtained from the questionnaires. The one- way analysis of variance was used as an inferential statistical procedure to test the hypotheses.

RESULTS AND DISCUSSIONS

During the data gathering exercise, a total of 120 questionnaires were administered to the three groups, with each group receiving 40 questionnaires. Table 1below shows the distribution of the questionnaires and the response rates. In order to avoid group dominance in the result of the research, equal numbers of respondents' were selected from the various groups. The minimum response of 21 from the Bank Loan Executives group was used as the reference datum for selecting the other two groups. The questionnaires consequently analyzed are as shown in table 2. The demographic characteristics of the respondents whose responses were analyzed are shown in table 3.

Dependence of the Auditor on the Audit Client

Table 4 shows that there is a strong agreement on the factors that indicate that the Nigerian auditors are not independent. From the table, 47.6% strongly affirm the position that Nigeria auditors are not independent of their clients while 38.1%agree. Only 14.29% are either undecided, disagree or strongly disagree. This gives a mean response of 4.0 in favour of the question with a standard deviation of 1.24. The results also indicate that the premium placed on the auditor's reports is a direct function of the auditor's independence while at the same time supporting the view that the auditor's report in Nigeria lack credibility. The implication of the above two statements is that the Nigerian auditor lacks independence. The result also indicates an affirmative support for the views (i) that there is a high competition for audit clients in Nigeria; (ii) that the most Nigerian Auditors are economically dependent on their audit clients; and (iii) that the level of competition in the Nigerian society is very high. When combined with the result on the factors affecting auditor's independence, the conclusion will be that the Nigerian auditor is not independent of the audited company.

Regulatory Framework and Auditor's Independence in Nigeria

From the analysis on table 5, 38.10% strongly agree that the Nigeria extant regulations on accounting and auditing cannot guarantee the independence of the auditor. 36.51% agree; 15.87% is undecided while 1.59% and 7.94 strongly disagree and disagree respectively. This gives a mean of 3.5 and a standard deviation of 1.15. There is also general affirmative support for the other questions to the effect that the extant Nigeria laws and regulations on accounting and auditing have not improved the independence of the auditor.

Factors Affecting Auditor's Independence

Certain factors have contributed to the low level of auditors' independence in Nigeria. The results in table 6 show that the competition for audit clients by audit firms impairs auditor's independence. This position was supported by a mean response of 3.95 and a standard deviation of 1.36. Also the results indicate with a mean response of 4.60 and a standard deviation of 0.63 that familiarity brought about by long auditor's tenure in a client company constitutes a threat to auditors' independence. Other factors which were supported by the analysis are : (i)That the provision of non-auditing services by Nigerian auditors to audit clients negatively affects auditors' independence (mean response of 3.95 and standard deviation of 1.36); (ii)That auditors' independence in a highly corrupt society like Nigeria is likely to be low (mean response of 3.94 and a standard deviation of 1.36); (iii)That a strong financial condition of the audited company negatively affects auditors' independence (mean response of 4.52 and standard deviation of 0.50). That the loss of auditors' independence is greater for small companies than for bigger ones (mean of 4.27 and standard deviation of 0.78).

Remedy for Auditors' Independence

Various means exist for mitigating loss of auditors' independence. The results show an affirmative support for the establishment of an independence body to regulate audit practice in Nigeria. Presently audit practice is regulated principally by the professional body, namely the Institute of Chartered Accountants of Nigeria (ICAN).

With a mean a mean response of 3.87 and a standard deviation of 0.92, it is clear that Nigerians support the regulation of audit practice in Nigeria by an independent body. Another remedy that was widely supported with a mean response of 4.25 and standard deviation of 0.69, was the proposition that there should be prohibition of audit firms from rendering non-audit service to clients. The research did not however, delve into the extent of such prohibition. To provide a useful guide on the probability of loss of auditors' independence from published financial statements, the results supported the view that both the audit fees for non - audit service and other out-of-pocket expenses paid to the auditor should be separately disclosed in the financial statements. Another suggestion that receive the overwhelming support of respondents is that there should be a limitation on the continuous tenure of an audit firm in a particular audit client company.

TEST OF HYPOTHESES

Table 8 show a summary of the result of the testing of the hypotheses. The first hypothesis was tested with a combination of questions 1, 2 and 3. The result shows a calculated value of F = 3.73 which is greater than table value of F = 3.15. Thus the hypothesis was accepted. The second hypothesis says that the credibility of the auditors' work/services is positively correlated with the auditors' independence. This was tested with question 2 which says that the premium placed on the auditors' report is a direct function of the perceived independence of the auditor. The result gave a calculated value of F =5.46 which is greater than the table value of F=3.15. The third hypothesis states that there is a positive correlation between the size of the audit firm and the auditor's independence. The third hypotheses was tested with question 17 and it yielded a calculated value of F= 15 which is greater than the table value of F=3.15. Thus, the hypothesis was accepted. The fourth hypothesis says that the competition for audit clients by audit firms in Nigeria adversely affects auditors' independence. This hypothesis yield a calculated value of F=53.82 which is greater than the table value of F=3.15, hence the hypothesis was accepted. The fifth hypothesis says that the legal and professional provisions/regulations cannot adequately guarantee auditors' independence in Nigeria This hypothesis was tested with questions 7,8 and 10. The test gave a calculated of F= 13.83 which is greater than the table value of F =3.15, hence the hypothesis was also accepted. The sixth hypothesis states that the provision of non-audit services by auditors in Nigeria adversely affect their independence. This hypothesis was tested with question 14. The test gave a calculated value of F= 53.81 which is greater than the table value of F= 3.15, hence the hypothesis was accepted.

SUMMARY OF FINDINGS, CONCLUSIONS AND RECOMMENDATIONS.

The study was out to examine the perception of auditors. Bank loan Executive and Financial Analyst on the independent of the Auditors in Nigeria. From the study of the following findings were made:(i)The Nigeria auditors' is not independent of the audit client;(ii) There is a belief that the auditors' report in Nigeria lack credibility This result from the fact that the premium placed on auditors' report is a direct function of the perceived independent of the auditor, which in the case of Nigeria the study affirmed to be lacking; (iii)the risk of loss of auditors' independence in Nigeria is greater for small firms than for the bigger firms. This is attributable mainly to the fact of the economic dependence of the smaller firms on their audit clients "(iv) the high competition for audit clients by audit firms in Nigeria contributes to the low level of auditors' independence in Nigeria;(v)The existing regulatory framework of auditing in Nigeria cannot guarantee auditors' independence;^) Familiarity brought about by long auditors' tenure in a client company constitute a threat to auditors' independence in Nigeria; (vii)the highly corrupt Nigerian environment is a contributory factor to the low level of auditors' independence in Nigeria; (ix)the provision of non-audit services by auditors to their audit clients is also perceived to adversely affect auditors' independence.

The issue of auditors' independence will continue to be of interest in Nigeria just the way it is in other countries of the world. From this study it can be concluded that Nigeria auditors' are not independent of their clients. This was attributed in the study to a number of factors, chief of which is the failure of regulation. The study will therefore be of interest to policy makers and the various professional accounting bodies in the country. Based on the findings and conclusion above, the following recommendations are made towards increasing the level of auditors' independence in Nigeria: (i) An independent body should be established to regulate audit practice in Nigeria. The task of qualifying auditors' to practice should be left to the professional bodies. However, auditor registration to practice and be disciplined should be carried out by an independent body which should also set auditing standards. However, such an independent body may be restricted to the auditors of publicly quoted companies; (ii)Auditors should be prohibited from rendering non-audit service to their clients; (iii)audited financial statements should disclose both the audit fees, non-audit services fees and all out of pocket expenses paid to the auditor during the financial year. This will enable the user of financial statements to assess the probability of loss of auditors' independence; (iv) there should be a limitation on the continues tenure of an audit firm in a particular audit client. This is intended to remove the familiarity threat to auditors' independence.

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Table 1 Questionnaire Distribution

Respondents	No. of Questionnaires administered of	No. of Questionnaires Returned	Response Rate (%)
Auditors	40	34	85.00
Bank Loan Executives	40	21	52.50
Financial Analysts	40	35	87.50
Total	120	90	75.00

Table 2 Number of Questionnaires Found Useful

Respondents	Number of Questionnaires Received	Number of Questionnaires Analyzed	Number of Questionnaires rejected	Percentage of Questionnaires Analyzed
Auditors	34	21	13	61.76
Bank Loan Executives	21	21	-	100.00
Financial Analysts	35	21	14	60.00
Total	90	63	27	70.00

Table 3 Demographic Characteristics of Respondents

AGE	FREQUENCY	PERCENTAGE
21-30years	6	9.52
31-40years	33	52.38
41-50years	16	25.40
51 years and above	8	12.70
Total	63.00	100.00
GENDER		
Male	40	63.49
Female	23	3(51
Total	63.00	100.00
YEARS WORKED		
Under 5 years	5	7.94
06-lOyears	10	15.87
ll-15years	12	19.05
21-25years	8	12.70
26-30years	8	12.70
31 years and above	10	15.87
Total	63	100

Table 4 Dependence of Auditors on the Audit Clients

S/ N	Questions	SA	A	U	D	SD	Mean	Stan. Dev.
1.	The Nigerian auditor is not generally independent of tile client	30 (47.6%)	24 (38.10%)	1.00 (1.59%)	1.00 (1.59)	7.00 (11.11%)	4.0	1.24
2	The premium placed on auditor report is a direct function of the perceived independence of the auditor. ,	31 (49.21%)	22.00 (42.86%)	2.00 (3.17%)	1.00 (1.59%)	2.00 (3.17%)	4.38	0.82
3	The auditor 's report in Nigeria lacks credibility	11 (65.08%)	22 (34.92%)	0 (0%)	0 (0%)	0 (0%)	4.65	0.48
4	There is a high competition for audit clients by audit firms in Nigeria.	31 (49.21%)	16 (25.40%) s	3 (4.76%)	1 (1.59%)	12 (1.59%)	3.84	1.51
5	Most Nigerian auditors are economically dependent on their audit clients	28 (44.44%)	23 (36.51%)	5 (7.94%)	0 (0%)	7 (11,11%)	4.03	1.23
6	The level of corruption in the Nigeria society is very high.	29 (46.03%)	30 (47.62%)	4 (6.35%)	0 (0%).	0 (0%)	4.40	1.05

Table 5 regulatory frame work and auditors' independence

S/N	QUESTION	SA	A	U	D	SD	Mean	Stan. ev.
7.	The extant Nigeria laws on accounting and auditing cannot guarantee auditors' independence.	24 (38.10%)	23 (36.51%)	10 (15.87%)	1 (1.59%)	5 (7.94%)	3.95	1.15
8	The professional accounting bodies do not have the capacity to adequately monitor the independence of their members.	32 (50.79%)	25 (39.68%)	2 (3.17%)	3 (4.76%)	1 (1.59%)	4.35	0.86
9	The directors' control of the appointment and remuneration of auditors in Nigeria nagatively affects the auditors' independence	26 (41.27%)	22 (34.93%)	6 (9.52%)	2 (3.17%)	7 (3.17%)	11.11	1.45
10	The establishment of audit committees has not improved auditor independence in Nigeria	29 (46.03%)	24 (38.10%)	6 (38.10%)	0 (0%)	4 (6.35%)	4.17	1.05

Table 6 Factor affecting auditors' independence

Q	QUESTION	SA	A	U	D	SD	Mean	Stan
11	The competition for audit client by audit firms impairs the auditors' independence.	30 (47.62%)	20 (31.75%)	0 (0%)	6 (9.52%)	7 (11.11%)	3.95	1.36
12	Familiarity brought about by long auditors tenure in a client company constitutes a threat to auditors' independence	43 (68.25%)	15 (23.81%)	5 (7..94%)	0 (0%)	0 (0%)	4.60	0.63
13	Auditors' independence is negatively affected by the economic dependence of the auditor on the Auditee	26 (41.27%)	23 (36.51%)	1 (11.59%)	4 (6.35%)	9 (14.35%)	3.84	1.39
14	The provision of non -audit services by Nigerian Auditor to audit clients negatively affect auditors' independence	30 (47.62%)	20 (31.62%)	0 (0%)	6 (9.52%)	7 (11.11%)	3.95	1.36
15	Auditors' independence in a highly corrupt society is likely to below	30 (47.62%)	20 (31.62%)	2 (31.75%)	1 (31.75%)	10 (1.59%)	3.94	1.36
16	Strong financial condition of the audit client negatively affects the independence of the auditor	28 (44.44%)	24 (38.10%)	9 (14.29%)	0 (0%)	2 (3.17%)	4.27	0.50
17	The risk of loss of auditors' independence is greater for small firms than for bigger firms	30 (47.62%)	20 (31.75%)	13 (20.63%)	0 (0%)	0 (0%)	4.27	0.78

Table 7 Remedy for Auditors' indepen dence

S/ N	QUESTION	SA	A	U	D	SD	Mean	Stan Dev.
18	The establishment of an independent body to regulate audit practice in Nigeria will improve auditors' independence	17 (26.98%)	25 (39.68%)	19 (30.68%)	0 (0%)	2 (3.17%)	3.87	0.92
19	Prohibition of audit firms from rendering non -audit services to their clients will improve auditors' independence	25 (39.68%)	29 (46.03%)	9 (14.29%)	0 (0%)	0 (0%)	4.25	0.69
20	Audited financial statements should disclose both the audit fees, non - audit fees and other out -of-pocket expenses paid to	24 (38.10%)	23 (36.51%)	10 (15.87%)	1 (1.5 9%)	5	3.95	1.15
21	There should be a limitation on the continuous tenure of an	25 (39.68%)	29 (46.03%)	9 (14.29%)	0 (0%)	0 (0%)	4.25	0.69

Table 8 Summary of Hypotheses Testing

Hypotheses	F- Calculated	F-Table	Decision
1.	**3.73**	**3.15**	**Accepted**
2.	**15.00**	**3.15**	**Accepted**
3.	**53.82**	**3.15**	**Accepted**
4.	**13.83**	**3.15**	**Accepted**
5	**53.81**	**3.15**	**Accepted**