

# INTERNATIONAL JOURNAL OF RESEARCH IN COMMERCE, IT & MANAGEMENT

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**PERCEPTIONS OF ACCOUNTANTS ON FACTORS AFFECTING AUDITOR'S INDEPENDENCE IN NIGERIA**

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**ABSTRACT**

*Independence is critically important to an auditor as it is regarded as being one of the fundamental principles underlying the auditor's work. The financial markets must have confidence in the integrity and objectivity of auditors. Without definite independence, audits have little value. This study examines factors affecting auditor's independence in Nigeria. Survey research design was employed in carrying out the study. Data were collected using Likert- rated questionnaire; which was administered to 150 Chartered Accountants in 15 Audit firms in Lagos. Sampled audit firms were selected randomly. Analysis was carried out using descriptive statistics, while the 5 hypotheses formulated were tested for significance using the chi-square test. The results revealed a significant relationship between the variables of: size of audit firm, level of competition in the audit services market, tenure of an audit firm serving the needs of a given client, size of audit fees received by audit firm in relation to total percentage of audit revenue and the provision of non-audit service on one hand; and auditor's independence on the other. The main recommendation is that auditors should remain strictly independent and not to provide audit clients with any other advisory services.*

**KEYWORDS**

Audit Fee, Auditor's Independence, Competition, Firm Size.

**INTRODUCTION**

Independence is critically important to an auditor as it is regarded as being one of the fundamental principles underlying the auditor's work. The financial markets must have confidence in the integrity and objectivity of auditors. Without definite independence, audits have little value. Recently, researchers, regulators and the public have been concerned about auditors' independence in the current audit environment where severe audit failures like Enron and WorldCom, have emerged. Independence has been the focus of almost constant controversy, debate and analysis (Law, 2008).

**REVIEW OF LITERATURE**

Abeygunasekera (2010) observed that auditors' independence is a topic that is being discussed throughout the world as an important aspect of the accountancy profession. It is both an ethical and a professional issue, crucial to auditors. Auditor independence is a cornerstone of the auditing profession, a crucial element in the statutory corporate reporting process and a key prerequisite for the adding of value to an audited financial statement (Ye, Carson, & Simnett, 2006; Olagunju, 2011)

With respect to the meaning of the concept of auditors' independence, Abeygunasekera (2010) opines that there are three meanings which can be given. First, in the sense of not being subordinate, it means honesty, integrity, objectivity and responsibility. Second, in the narrow sense, in which it is used in connection with auditing and expression of opinions on financial statements, independence means avoidance of any relationship which would be likely, even subconsciously, to impair the objectivity as auditor. Third, it means avoidance of relationships, which to a reasonable observer would suggest a conflict of interest.

Discussion on auditor's independence evolves around two forms: independence in fact and independence in appearance. The former requires auditors to form and express an opinion in the audit report as a disinterested and expert observer, uninfluenced by personal bias during the audit engagement, while the latter expects auditors to avoid situations that might cause others to conclude that they are not maintaining an unbiased, objective attitude of mind (Hudaib & Haniffa, 2009).

Third party users expect the auditor to find and report all problems with the financial statements while management wants the auditor to ignore financial statements manipulation. Thus, at times, the auditor needs to choose from these conflicting needs (Faraj & Akbar, 2010). The auditor's role conflict may negatively impact the auditor's independence and the ability to conduct a just audit. If the auditor tries to be adamantly ethical in a situation of conflict, management may seek to replace the auditor. As a result, the auditor may buckle under management's pressure, resulting in a compromise of auditors' independence (Alleyne, Devenish & Alleyne (2006).

Previous studies revealed that the most important independence-influencing factors include: audit firm size, competition level, provision of non-audit service, tenure of an audit firm serving the needs of a given client, and size of audit fees (Abu-Bakar, Abdul-Rahman & Abdul-Rashid, 2005; Krishnan, Sami, & Zhang, 2005; Abu-Bakar, 2006; Law, 2008; Salehi, 2008; Abeygunasekera, 2010; Al-Ajmi, & Saudagaran, 2011).

**SIZE OF AUDIT FIRM**

Larger audit firms are often considered to be more able to resist pressures from management (i.e. higher auditor's independence). This is proven by almost all of the empirical studies that attempted to find the relationship between audit firm size and auditor's independence, whereby they found that there is a positive relationship between them (Alleyne et al., 2006; Abu-Bakar et al., 2005). In fact, it has been argued that certain characteristics inherent in small audit practices may increase the danger of impairment of independence, for example, the tendency toward a more personalized mode of service and close relationship with the client (Robert & Darryl, 2009)). However, one should not conclude that large firms are immune to pressures from their clients.

**LEVEL OF COMPETITION IN THE AUDIT SERVICES MARKET**

Competition has been identified as the most important environmental change or external factor affecting auditor independence (Law, 2008). Firms operating in an intensely competitive environment may have difficulty remaining independent since the client can easily obtain the services of another auditor. A number of empirical studies have proven that the high level of competition in the audit firm has resulted in less auditor independence (Alleyne et al., 2006; Abu-Bakar & Ahmad, 2009). Krishnan et al., (2005) however, found the opposite. In explaining this, they argued that the existence of competition caused auditors to be more independent and create a favourable image in order to maintain their clientele.

### TENURE OF AN AUDIT FIRM SERVING THE NEEDS OF A GIVEN CLIENT

An audit firm's tenure, which is the length of time it has been filling the audit needs of a given client, has been mentioned as having an influence on the risk of losing an auditor's independence. Most writers, who discuss the relationship between tenure and auditors' independence, support this view (Alleyne et al., 2006; Abu-Bakar & Ahmad, 2009). A long association between a corporation and an accounting firm may lead to such close identification of the accounting firm with the interests of its client's management that truly independent action by the accounting firm becomes difficult. It was also pointed out that complacency, lack of innovation, less rigorous audit procedures and a learned confidence in the client may arise after a long association.

### SIZE OF AUDIT FEES RECEIVED BY AUDIT FIRM (IN RELATION TO TOTAL PERCENTAGE OF AUDIT REVENUE)

Large size of audit fees is normally associated with a higher risk of losing the auditor's independence. Millichamp (1996) cited in ICAN (2006) considers undue dependence on an audit client as a potential threat to auditor's independence. Public perception of independence may be put in jeopardy if the fees from any one client or group of connected clients exceed 15% of gross practice income or 10% in the case of listed companies (ICAN, 2006). In such event, the only course of action is to refuse to perform or withdraw from the assurance engagement.

### PROVISION OF NON-AUDIT SERVICE

Early research related to financial statement users indicated that auditor independence is negatively affected when non-audit services are performed for audit clients (Abu-Bakar et al., 2005; Alleyne et al., 2006; Krishnan et al., 2005). They believe that these collateral services create a working relationship between the auditor and the client that is too close and that the provision of management advisory services negatively affected auditor's independence.

Contrary to the above, some other studies found a positive relationship between management advisory services provision and auditor's independence. They believe that management advisory services provision enhances the auditor's knowledge of the client, thus increasing the auditor's objectivity (Goldwasser, 1999; Ashbaugh, LaFond, & Mayhew, 2003).

### IMPORTANCE OF THE STUDY

The audit of financial statements in the corporate sector by an independent auditor is mandatory by statute, which defines his duties, rights and powers (Salehi, Mansoury & Azary, 2009). It is essential because of the separation of ownership of business from the management in the corporate sector as the former needs somebody who can keep an expert watch on the latter and to whom they can depend for the reliability of accounts as the preparation of financial statement is the prerogative of the management. The auditor has not much to suggest on the form and adequacy of financial statement; but to express an opinion on whether the report prepared by management represents a truth and fair view of the business as at that date. Independence is fundamental to the reliability of auditors' reports in this regard. Those reports would not be credible, and investors and creditors would have little confidence in them, if auditors were not independent in both fact and appearance.

### STATEMENT OF PROBLEM

Auditor independence has received considerable attention in recent years. This is due to the fact that independently audited financial statements may result in the generation of true and fair accounting information which will help stakeholders to form rational expectations about firms and minimise the agency cost. It can also be argued that lack of independence would lead auditors to collaborate with the management of firms and would produce misleading accounting information.

In recent times, media comments on corporate scandals rocking the Nigeria Corporate organizations, especially the banking industry have tended to focus heavily on the issue of auditor independence (Ajagunna, 2012). These financial scandals had a detrimental effect on the public's perception of auditors. More worryingly, the issues related to independence are threatening the survival of accounting firms of all sizes and indeed it has the power to destroy the accountancy profession as a whole (Abu-Bakar, & Ahmad, 2009). It is therefore, vital that auditors maintain their independence and ensure that they provide a high quality of auditing to ensure the credibility of financial information not only for the purpose of reducing the number of corporate scandals but most importantly the survival of their profession and the development of healthy financial and capital market (Abu-Bakar, 2006). Thus there is the need to examine the factors that affect auditors' independence in Nigeria.

### OBJECTIVES

The main objective of this study is to investigate the perceptions of professional accountants in Nigeria on factors influencing auditors' independence. Specifically, the study sets out to:

1. Investigate whether the size of audit firm affects auditor's independence.
2. Examine whether the level of competition in the audit services market affects auditor's independence.
3. Investigate whether the tenure of an audit firm serving the needs of a given client affects auditor's independence.
4. Explore whether the size of audit fees received by audit firm in relation to total percentage of audit revenue affects auditor's independence.
5. Investigate whether the provision of non-audit service affects auditor's independence.

The following research questions have also been developed mainly based on the development of literature on auditor independence:

1. Does the size of audit firm affect auditor's independence in Nigeria?
2. Does the level of competition in the audit services market affect auditor's independence in Nigeria?
3. Does the tenure of an audit firm serving the needs of a given client affect auditor's independence in Nigeria?
4. Does the size of audit fees received by audit firm in relation to total percentage of audit revenue affect auditor's independence in Nigeria?
5. Does the provision of non-audit service affect auditor's independence in Nigeria?

### HYPOTHESES

In order to be able to test the significance of the relationship that exists between the identified factors and auditor's independence, the following hypotheses have been formulated:

Ho<sub>i</sub>: There is no significant relationship between size of audit firm and auditor's independence.

Ho<sub>ii</sub>: There is no significant relationship between the level of competition in the audit services market and auditor's independence.

Ho<sub>iii</sub>: There is no significant relationship between the tenure of an audit firm serving the needs of a given client and auditor's independence.

Ho<sub>iv</sub>: There is no significant relationship between the size of audit fees received by audit firm in relation to total percentage of audit revenue and auditor's independence.

Ho<sub>v</sub>: There is no significant relationship between the provision of non-audit service and auditor's independence.

Chi-square test with 5% level of significance was employed in testing the hypotheses. The decision rule is to reject the null hypothesis if the calculated value is greater than the critical value and accept if otherwise. Chi-square is calculated with the help of the following formula.

$$X^2 = \sum \frac{(O_{ij} - E_{ij})^2}{E_{ij}}$$

Where O<sub>ij</sub> = represents observed frequency; E<sub>ij</sub> = represents expected frequency

E= Number of questionnaire

Number of response

Level of significant= 0.05; Formula for degree of freedom= n-1; Therefore the degree of freedom df= 5-1 = 4. Thus, the value of  $\chi^2$  from that 4 degree of freedom at 5% significance is 9.49

**RESEARCH METHODOLOGY**

The study adopts a survey research design. Five-point rating scaled questionnaire starting from strongly agreed (SA), agreed (A), undecided (U), disagreed (D), and strongly disagreed (SD) was used to collect data from randomly selected Audit firms in Nigeria. The questionnaire was designed in such a way that every question in the questionnaire was related to the research questions.

**RESULTS AND DISCUSSION**

The perceptions of the respondents on the various statements put forward in the questionnaire are analyzed as follows:

**TABLE 1: ANALYSIS OF RESPONSES TO STATEMENT 1 IN THE QUESTIONNAIRE: THE SIZE OF AUDIT FIRM AFFECTS AUDITOR'S INDEPENDENCE**

S/No.	Responses	No. of responses	% of Responses
1	Strongly agree	62	41.33
2	Agreed	46	30.67
3	Undecided	13	8.67
4	Disagreed	11	7.33
5	Strongly disagreed	18	12.00
Total		150	100

Source: Field Survey, 2012

The analysis of responses to statement number one reveals that most of the respondents agreed that the size of audit firm affects auditor's independence.

**TABLE 2: ANALYSIS OF QUESTIONNAIRE BASED ON HYPOTHESIS 1**

Observed (O)	Expected (E)	(O - E)	(O - E) <sup>2</sup>	(O - E) <sup>2</sup> /E
62	30	32	1,024	34.1333
46	30	16	256	8.5333
13	30	-17	289	9.6333
11	30	-19	361	12.0333
18	30	-12	144	4.8000
				$\chi^2$ 69.1332

Source: Field Survey, 2012

The result of the hypothesis one indicates an  $\chi^2$  value of 69.1332 which is greater than the critical value of 9.49. Therefore, we reject the null hypothesis and accept the alternative hypothesis. Thus we conclude that there is a significant relationship between size of audit firm and auditor's independence

**TABLE 3: ANALYSIS OF RESPONSES TO STATEMENT 2 IN THE QUESTIONNAIRE: THE LEVEL OF COMPETITION IN THE AUDIT SERVICES MARKET AFFECTS AUDITOR'S INDEPENDENCE**

S/No.	Responses	No. of responses	% of Responses
1	Strongly agree	78	52.00
2	Agreed	47	31.33
3	Undecided	11	7.33
4	Disagreed	6	4.00
5	Strongly disagreed	8	5.33
Total		150	100

Source: Field Survey, 2012

The analysis of responses to statement number two reveals that most of the respondents agreed that the level of competition in the audit services market affects auditor's independence.

**TABLE 4: ANALYSIS OF QUESTIONNAIRE BASED ON HYPOTHESIS 2**

Observed (O)	Expected (E)	(O - E)	(O - E) <sup>2</sup>	(O - E) <sup>2</sup> /E
78	30	48	2,304	76.8000
47	30	17	289	9.6333
11	30	-19	361	12.0333
6	30	-24	576	19.2000
8	30	-22	484	16.1333
				$\chi^2$ 133.7999

Source: Field Survey, 2012

The result of the hypothesis two indicates an  $\chi^2$  value of 133.7999 which is greater than the critical value of 9.49. Therefore, we reject the null hypothesis and accept the alternative hypothesis. Thus we conclude that there is a significant relationship between the level of competition in the audit services market and auditor's independence.

**TABLE 5: ANALYSIS OF RESPONSES TO STATEMENT 3 IN THE QUESTIONNAIRE: THE TENURE OF AN AUDIT FIRM SERVING THE NEEDS OF A GIVEN CLIENT AFFECTS AUDITOR'S INDEPENDENCE**

S/No.	Responses	No. of responses	% of Responses
1	Strongly agree	71	47.33
2	Agreed	48	32
3	Undecided	7	4.67
4	Disagreed	21	14
5	Strongly disagreed	3	2
Total		150	100

Source: Field Survey, 2012

The analysis of responses to statement number three reveals that most of the respondents agreed that the tenure of an audit firm serving the needs of a given client affects auditor's independence.

**TABLE 6: ANALYSIS OF QUESTIONNAIRE BASED ON HYPOTHESIS 3**

Observed (O)	Expected (E)	(O – E)	(O – E) <sup>2</sup>	(O – E) <sup>2</sup> /E	
71	30	41	1,681	56.0333	
48	30	18	324	10.8000	
7	30	-23	529	17.6333	
21	30	-9	81	2.7000	
3	30	-27	729	24.3000	
				X <sup>2</sup>	111.4666

Source: Field Survey, 2012

The result of the hypothesis three indicates an x<sup>2</sup> value of 111.4666 which is greater than the critical value of 9.49. Therefore, we reject the null hypothesis and accept the alternative hypothesis. Thus we conclude that there is a significant relationship between the tenure of an audit firm serving the needs of a given client and auditor's independence

**TABLE 7: ANALYSIS OF RESPONSES TO STATEMENT 4 IN THE QUESTIONNAIRE: THE SIZE OF AUDIT FEES RECEIVED BY AUDIT FIRM IN RELATION TO TOTAL PERCENTAGE OF AUDIT REVENUE AFFECTS AUDITOR'S INDEPENDENCE**

S/No.	Responses	No. of responses	% of Responses
1	Strongly agree	41	27.33
2	Agreed	62	41.33
3	Undecided	19	12.67
4	Disagreed	19	12.67
5	Strongly disagreed	9	6.00
Total		150	100

Source: Field Survey, 2012

The analysis of responses to statement number four reveals that most of the respondents agreed that the size of audit fees received by audit firm in relation to total percentage of audit revenue affects auditor's independence.

**TABLE 8: ANALYSIS OF QUESTIONNAIRE BASED ON HYPOTHESIS 4**

Observed (O)	Expected (E)	(O – E)	(O – E) <sup>2</sup>	(O – E) <sup>2</sup> /E	
41	30	11	121	4.0333	
62	30	32	1,024	34.1333	
19	30	-11	121	4.0333	
19	30	-11	121	4.0333	
9	30	-21	441	14.7000	
				X <sup>2</sup>	60.9332

Source: Field Survey, 2012

The result of the hypothesis four indicates an x<sup>2</sup> value of 60.9332 which is greater than the critical value of 9.49. Therefore, we reject the null hypothesis and accept the alternative hypothesis. Thus we conclude that there is a significant relationship between the size of audit fees received by audit firm in relation to total percentage of audit revenue and auditor's independence.

**TABLE 9: ANALYSIS OF RESPONSES TO STATEMENT 5 IN THE QUESTIONNAIRE: THE PROVISION OF NON-AUDIT SERVICE AFFECTS AUDITOR'S INDEPENDENCE**

S/No.	Responses	No. of responses	% of Responses
1	Strongly agree	88	58.67
2	Agreed	43	28.67
3	Undecided	14	9.33
4	Disagreed	4	2.67
5	Strongly disagreed	1	0.67
Total		150	100

Source: Field Survey, 2012

The analysis of responses to statement number five reveals that most of the respondents agreed that the provision of non-audit service affects auditor's independence.

**TABLE 10: ANALYSIS OF QUESTIONNAIRE BASED ON HYPOTHESIS 5**

Observed (O)	Expected (E)	(O – E)	(O – E) <sup>2</sup>	(O – E) <sup>2</sup> /E	
88	30	58	3,364	112.1333	
43	30	13	169	5.6333	
14	30	-16	256	8.5333	
4	30	-26	676	22.5333	
1	30	-29	841	28.0333	
				X <sup>2</sup>	176.8665

Source: Field Survey, 2012

The result of the hypothesis five indicates an x<sup>2</sup> value of 176.8665 which is greater than the critical value of 9.49. Therefore, we reject the null hypothesis and accept the alternative hypothesis. Thus we conclude that there is a significant relationship the provision of non-audit service and auditor's independence.

**FINDINGS**

The findings of this study include the following:

- (i) There is a significant relationship between size of audit firm and auditor's independence
- (ii) There is a significant relationship between the level of competition in the audit services market and auditor's independence
- (iii) There is a significant relationship between the tenure of an audit firm serving the needs of a given client and auditor's independence.
- (iv) There is a significant relationship between the size of audit fees received by audit firm in relation to total percentage of audit revenue and auditor's independence.
- (v) There is a significant relationship the provision of non-audit service and auditor's independence.

**RECOMMENDATIONS**

The following recommendations are deemed appropriate at this juncture.

11. For auditors to remain strictly independent, they should not be allowed to provide audit clients with any other advisory services.
  2. There should be rotation of auditors to improve the auditors' independence.
  3. There should be an implementation of peer assessment in order to ensure that audits are carried out with utmost professionalism and mutual respect.
  4. An audit committee should be set up by every limited liability company to evaluate the audit work done.
- It is anticipated that when all these are done it will help the auditor to be independent and also enhance the credibility of audited financial statements.

## CONCLUSION

From the literature review and analysis of data, it could be concluded that each of the five factors of: size of audit firm, level of competition in the audit services market, tenure of an audit firm serving the needs of a given client, size of audit fees received by audit firm in relation to total percentage of audit revenue, and the provision of non-audit service has a significant relationship with auditor's independence.

## SCOPE FOR FURTHER RESEARCH

This study focuses on the perceptions of Professional Accountants who serve in the various audit firms alone. There is the possibility of expanding the scope of future research on this subject. Other stakeholders such as accountants working in the industry, staff members of internal audit/accounts department of organizations, managers of corporate organizations and Accounting Scholars who lecture in Universities and other post secondary schools should be integrated into future study on this subject. This will result into more robust research findings on the perceptions of auditor's independence.

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