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The Impact of Client Economic Power and Value on the Independence of Auditors in Nigeria: Quantitative Analysis Comparing Financial Strength with Audit Remuneration

Daramola Adedeji Adebola[1*] Ayinde Ahmed Bolakale[2] Daramola Lilian Ejiro[3]
1.Owena Energy Limited, Akure, Nigeria.
2.College of Social and Management Science, Afe Babalola University, P.M.B. 5454, Afe Babalola Way, Ado-Ekiti, Nigeria.
3.OxPeach Strategy Limited, Lagos, Nigeria

Abstract
This paper looks into the possibility that the Economic power possessed by clients might affect the level of external auditor's independence in Nigeria. It explores the possibility that the comparability of financial strength of clients to that of audit firms could lead to intimidation threat. The study makes use of the annual report of 6 out of the Most Valuable entities in Nigeria as evaluated and published by Nigeria Bulletin in 2014. The study carried out a linear regression analysis of the relationship between audit remuneration and firm size and total administrative expenses. The result showed that audit remuneration has a positive significant relationship with administrative expenses, although only about 40% change in administrative expense could be attributed to audit fee as depicted by the coefficient of determination (R^2), the other result showed a positive significant relationship between audit remuneration and firm size, with very high correlation coefficient. This led to the conclusion that the financial strength of client has a strong impact on the fortune of auditor, which could affect the moral stance of auditors; it is therefore recommended that auditor maintain their independence principle no matter the circumstance.
Keywords: Audit Independence, Audit Remuneration, Firm Size, Auditor-Client Relationship.

1. Introduction

The unbiased opinion about the truth and fairness of annual report provided by the appointed external auditors of firms all over the world is a requirement that is made a requisite by the regulators and standard creators of these firms, especially the entities listed in the Nigerian Stock Exchange, this is done to ensure the annual report provided by public companies are of the quality that would enable users and the general public, have a true picture of the situation of the entities, which would help to improve the wealth creation capability in the economy (Windsor & Warming, 2009). Lack of independence of the auditors appointed by an entity may lead to audit failure that would defeat the purpose of preparing the financial statement in the first instance, (Windsor & Warming 2009).

Nigeria has experienced growth in its private sector over the last two decades, which has bought with it positive and negative effects on different aspects of economic activities. The growth of the economy came with some level of corruption and fraudulent accounting practices by business, which hurts the economy, this lead to the call for more strict regulation of the accounting and auditing profession, the auditors are at the heart of monitoring, hence ensuring their independence is important to ensuring transparent, reliable and relevant reporting is present in every economic activity in the nation. Nigeria is moving from a mono-product economy to a more diversified economy, therefore ensuring the private sector has all corporate governance elements is inevitable in helping the country reach its destination (Ayoola-Akinjobi, 2010).

The recent financial crisis that the global business world faced, which pushed some big firms into unethical accounting practice, in the watch of auditors is scary, because it indicates that auditor might be losing focus due to financial dependence when carrying out their duties, this daunting intimidation threat must be neutralized, so that audit could remain at the forefront amongst factors that could help in improving the fortunes of the capital market, via the quality of annual reports (Husam, Rana & Abdulhadi, 2013). Practitioners in the auditing sectors are expected to ensure their level of independence is never questionable, during their various engagements, to narrow it down; auditors are expected "to be fair, intellectually honest, and free of conflicts of interest" (International Federation of Accountants, 2005). The decision making process employed by auditors is said to be sometimes influenced by the personal psychological characteristics of the auditors, and also the perceived and evident client economic power, this could affect the audit quality, because auditors might not ask the right questions due to this factors (Windsor & Ashkanasy 1995; Windsor and Warming Rasmussen 2009). The recent spate of audit failures is beginning to make users of annual reports perceive auditors as practitioners that do not have the moral wherewithal to avoid bowing to the unavoidable pressure by powerful clients, (Windsor & Warming 2009).

This study was motivated by the need to emphasis the possible intimidation threat, that might be defeating the objective of appointing external auditors, study into factors that might lead to intimidation threat in Nigeria, is important due to the recent spate of financial malpractices in the economy, the study would make use of quantitative analysis of the financial position as it affects what auditor get paid using 6 of the most valuable entities in Nigeria as at 2014. The study is going to look at the quantitative factors that might explain the relationship between client economic power and level of independence. The research questions are:

- What is the contribution of audit fee to the changes in Administrative expenses of a client that is very valuable and successful?
- What is the relationship between firm size and audit fee?

2. Audit

Audit is defined as the systematic and procedural activity conducted by qualified accountants, to vet the books of accounts, transaction documents and financial reports in order to give an opinion on the truth and fairness of the annual reports for the consumption of users. Audit Failure on the other is the situation where auditors give a wrong opinion on the truth and fairness of the annual report, the failure is meant to be investigated before a conclusion can be reached as to the possibility of negligence or wrongdoing on the part of the auditor. Audit failure defeats the purpose of conducting audit in the first place, if auditors do whatever the clients want due to the perceived psychological power of the client, then they can as well be thrown away.

Audit risk indicates a situation where an auditor does not discover errors or intentional miscalculations (i.e. fraud) while reviewing a company's or individuals financial statements. There are allot of factors that could contribute to this risk, this study would make an exciting contribution to the body of research that examines factors that contribute to audit risk via auditor independence and threats to auditor independence.

2.1. Auditors Independence

Auditors must be independent in the process of carrying out their duties, their opinion must be an independent opinion, that is, the opinion must not be influenced by the opinions and views of their clients whose financial statement have been audited. Auditors are expected to not just be independent, but they must also be seen to be independent. In order that a member's audit report is of value auditors must have 'independence of mind' and be 'independent in appearance'. These principles of both being and being seen to be independent are at the centre of the role played by independence in auditing.

Auditor Intimidation Threat is one of the factors that are deemed to have the ability to threaten the independence and objectivity of auditors. The threat usually happens when auditor is afraid of losing a client, or when an auditor bows to the pressure of client due to the level of financial dependence on the client. It occurs when an auditor lets his independence to be compromised by threats by clients to use another firm if the auditor refuses to dance to his tune.

2.2. Agency Theory

The work by Jensen & Meckling (1976) form the foundation for agency theory, the theory is based on the business system whereby an investor or business owner called the "Principal" appoints another party called the "Agent" to run the established business on their behalf for the purpose of creating wealth for the owner and rendering appropriate. It is believed that an obvious source of conflict of interest is when the principal and agent try to maximise their utility, because agency theory is based on the premise that only the utility of the business owner should be maximised, regardless of the effect it has on the interest of any other stakeholder, hence, the objective of the agency relationship is easily defeated, once the agent make their interest a priority over that of the owners. The principal is therefore advised to employ mechanisms that would incentivise the agent to serve the interest of the shareholder solely and always, these mechanisms could involve monitoring cost which is referred to as "Agency Cost". A common tool is the situation whereby the agent is remunerated to avoid carrying out activities that are not in the interest of the owner, or to ensure that the principal would lose nothing when the agent goes against their wish.

Agency theory (Watts & Zimmerman, 1978) suggests that the auditor is appointed in the interests of both the third parties as well as the management. A firm is characterized by a chain of relationship that is governed by a contract based on fiduciary initiative. Several stakeholder groups (suppliers, bankers, customers, employees etc.) have some kind of service they provide to the entities for a given consideration. It is the role of the management to ensure the optimization of the relationship with the various groups to ensure the firm reaches its objective; the best way to do this is by avoiding any form of bias for the interest of any particular group. Management is there to make use of the relationship with these stakeholders (bankers, shareholders, employees etc.) in order to ensure the firm gets the services it requires to reach its goals. The most prominent and widely used audit theory is the agency theory. Audit is a monitoring tool to ensure the management reports factual information about the financial performance and position to the owners (Jensen & Meckling, 1976). Moreover, the authors also see external audit as a form of check and balance on the way resources are utilized by managers, the budgeting system and the internal control activities. External audit is both a way to monitor the way management is performing and a way to ensure management is made to justify the way they have conducted business in a particular financial period.

2.3. Wartenberg 'field theory of power' as related to auditing

The understanding of the Wartenberg (1990) "Field Theory of Power" is important to the concept this paper seeks to explain, the theory is a sociological conception of power that can be utilized to emphasis the tilt in the power tussle inherent in the auditor-client relationship that could impact the independence of auditor in a good or bad way. Wartenberg theory on power made a distinction between negative and positive power. The negative power is viewed as the power that enables the dominating party to exert some kind of influence over the weaker party that would in turn make it hard for the weaker party to act with a particular level of freedom. The dominator is equipped with allot of tools, including force, duress, manipulation and coercion that could all be employed to limit the freewill of the weaker party to explore the number of options available to them, when they are trying to make decisions.

Situational power is a major aspect of negative power that depicts a circumstance that emerges due to negotiation, it occurs when the dominating party could control the negotiation is done within an environment that could be influenced by the dominator, which could make the weaker party settle for whatever they are offered, due to little or no control over the terms of the negotiation. The Auditor-client relationship falls within the realms of Situational Power because the client has the ability to control the welfare of the auditor, and the information provided to the auditor. This control could be used to weaken the auditor's freewill to operate with the required level of independence (Wartenberg, 1990).

However, the tilt in power towards the client could have a positive or negative influence on the auditor, a good instance is where an auditor is made to serve the interest of the client in exchange for a contract to provide non-audit services (Wartenberg, 1990). Hence, the moral sensitivity of the prevalence of the client economic power in the auditor client relationship could affect the independence of the professional auditor in the short and long term.

2.4. Empirical Review

In a study conducted by Bo and Huishan, (2013) on the possible impact of audit tenure on auditor independence. The findings showed that firms that last long with clients, especially those that last for 10 years and above are likely to backdate options, however the result is found to be peculiar to small firms. Also, the study of Uchenna and Young, (2013) on the factors that determine auditor independence; comparing the opinion of auditors with non-auditors in Lagos using survey research tool, their result show that auditors and non-auditors have similar opinion as to the factors that make or mar the independence of auditors, but there were variations in the level of significance of the relationship.

Audit firm size is said to affect perception of level of auditor independence, a study on small firms owned showed that firms managed by a sole practitioner have the tendency to have their independence compromised due to intimidation threat, this means that small audit firms have the tendency to depend on clients that obviously control their survival (Al-Ajmi and Saudagaran, 2011). Provision of audit services simultaneously with non-audit service is said to impair independence because it makes auditor unduly dependent on clients financially , this is also important to the objective of this study because it is another indication that undue reliance on client, affects independence negatively (Schmidt, 2012).

The study of Omri and Akrimi, (2015) showed that main threats to auditor independence are the provision of non-audit service, the existence of personal and financial relations between auditor and client; however positive goodwill was discovered to improve auditor independence. The most influential factors that affect auditor independence were economic dependence and existence of personal and financial relationships.

The study of Fitriany, Sylcia and Viska, (2016) the investigate the impact of abnormal audit fee on audit quality in Indonesia showed that abnormal audit fee leads to lower audit quality, because it makes the client too powerful in the auditor client relationship, the findings of the study showed that discounted audit fee has a positive relationship with the quality of audit.

Table 1: Top 20 Most Valuable Companies in Nigeria as at 2014, November based on the Valuation by the Nigeria Stock Exchange.

Company	**Market Valuation (In Billion Naira)**
20. Cadbury Nigeria Plc	150.3
19. Union Bank Nigeria Plc	168.9
18. Flour Mills of Nigeria Plc	186.1
17. Transcorp Nigeria Plc	195.5
16. Unilever Nigeria Plc	204.3
15. Access Bank Plc	218.5
14. Forte Oil	222.9
13. UBA Group	253.9
12. OANDO	259.4
11. Stanbic IBTC Holdings Plc	260
10. Ecobank Transnational Incorporated	269.4
9. Guinness Nigeria	**301.8**
8. LAFARGE WAPCO	333.2
7. SEPLAT Petroleum	387.3
6. First Bank Plc	**509.1**
5. Zenith Bank	786.5
4. Guaranty Trust bank Plc	**852**
3. Nestle Plc	**911.6**
2. Nigerian Breweries	**1,300.7**
Dangote Cement	**4,089.7**

Source: Nigerian Bulletin (2014)

The bolded companies form the sample size of this study. They were chosen mainly due to their reputation, years of existence, and the intimidating capacity of individuals behind the foundation of the firms.

3. Research Method.

The research would analyse the percentage audit fee contributes to the administrative expenses of 6 of the biggest companies in Nigeria as at 2014 using the annual report of the most valuable companies provided in Table 1. Ordinary Least Square (OLS) regression would be used to determine the pattern of relationship between auditor remuneration and administrative expense on one hand, and audit remuneration and log of firm size (total asset) on the other hand. Coefficient of determination would also be used to determine the contribution of audit fee to the changes in administrative expenses. The coefficient of determination (R^2) is a measure of the proportion of variance of a predicted outcome. With a value of 0 to 1, the coefficient of determination is calculated as the square of the correlation coefficient (R) between the sample and predicted data. The result of the coefficient of determination is the main tool that would be used to reach the conclusion, because it is the one that would really tell us if the money paid to auditors has any form of effect on the operating cash flow of their clients.

3.1. Model Specification for Quantitative Analysis

Aud_Rem = $\beta_0 + \beta_1$ Admin_Exp + ε_i..(1)
Aud_Rem = $\beta_0 + \beta_1$ F_Size + ε_i..(2)
Where: Aud_Rem: Audit Remuneration
Admin_Exp: Administrative Expense
F_Size: Natural Logarithm of Firm Size

4. Research Result

Table 2 Descriptive Statistics of Data Employed for the Study (figures in N'000).

		Minimum	**Maximum**	**Mean**	**Standard Deviation**
Administrative Expenses	41	2,479,275	168,908,000	33,780,577	40,396,610
Total Asset	41	29,159,552	3,490,871,000	810,030,523	957,472,783
Audit Remuneration	41	19,100	300,000	103,645	91,669
Natural Log of Firm Size	41	17	22	20	1

Source: Author's Computation, 2016.

The table above shows the summary of the descriptive statistics of the financial statement items used for the research analysis carried out in the study. The maximum administrative expenses of the firms is N169 billion, the minimum is about N2 billion, the average is N34 billion and the standard deviation is N40 billion, this shows that the administrative expenses of the six firms choses follow a similar pattern. The highest total asset is N 3 trillion, the lowest is N 29 billion, the mean is N 810 billion and the standard deviation is N 957 billion, what this means is that the firms are similar in size. The highest fee paid to external auditors by the firms is N300 million, which when compared to the highest administrative expense is difference of approximately N169 billion, this is a first-hand indication that audit fee does not form a significant part of the administrative expense. The lowest audit fee is N19 million, average is N104 million and standard deviation is N92 million.

Table 3 Regression Result for Model 1 (Equation 1)

Variable	
Constant	57,384** 15,147 0.001
Administrative Expense Coefficient	0.001** 0.000 (0.000)
R	0.603 (60%)
R-Square	0.364 (36%)
F-statistic	22.340

Source: Author's computation 2016
Dependent variable: Audit Remuneration
Independent Variable: Administrative Expenses
The numbers with significant level are coefficient value, while the middle numbers are the standard error and Numbers in the parentheses refer to t-statistics.
***significant at 1 per cent level.*
**significant at 5 per cent level.*

The table above shows the result of the linear regression result which would help answer the second research question. The result gave a correlation coefficient (R) of 60% which means that there is strong positive relationship between administrative expenses and audit fee, but the coefficient of determination (R^2) gave 36% which indicates that only 36% changes in administrative expenses can be attributed to audit remuneration, this means that the audit fee does not have much impact on the administrative expenses of the firms. The coefficient of administrative expense in the linear regression equation (β_1) is 0.001, which means that for every 0.001 change in administrative expense there is 0.001 change in audit fee in the same direction, the coefficient is significant at 1% significant level, which means that the relationship between administrative expenses and audit fee is significant but weak given the correlation result.

Table 4 Regression Result for Model 2 (Equation 2)

Variable	
Constant	-1,037,937** 95,842 0.000
Natural Log of Firm Size.	58,000** 4,857 (0.000)
R	0.886 (89%)
R-Square	0.785 (79%)
F-statistic	142.576

Source: Author's computation 2016
Dependent variable: Audit Remuneration
Independent Variable: Natural log of Firm Size
The numbers with significant level are coefficient value, while the middle numbers are the standard error and Numbers in the parentheses refer to t-statistics.
***significant at 1 per cent level.*
**significant at 5 per cent level.*

The table above shows the result of the linear regression result which would help answer the third research question. The result gave a correlation coefficient (R) of 89% which means that there is strong positive relationship between the size of firms and the amount paid to auditor, so the bigger the company the bigger the audit fee, but the coefficient of determination (R^2) gave 79% which means that 79% difference in audit remuneration can be explained by difference in firm size, this means that auditor get more pay from bigger firms, which indicates the impact of client financial power on the fortune of auditors. The coefficient of administrative expense in the linear regression equation (β_1) is 58,000, which means that for every 58,000 change in firm size there is 58,000 change in audit fee in the same direction, the coefficient is significant at 1% significant level, which means that the relationship between firm size and audit fee is very significant, due to the t-statistic result of 0.000.

5. Conclusion.

When an individual or a corporation is wealthy it certainly would have the inclination to dominate every situation and also influence how people and the whole world perceive them. The Wartenberg Field theory of power talks about the Negative theory that a dominant party might have over the dependent party. In an audit-client relationship an auditor might be forced to dance to the tune dictated by the client, as the result of the study shows audit remuneration is highly correlated with firm size, which mean audit firms would do anything to keep big companies, because bigger clients translates to more income, the low coefficient of correlation an determination audit remuneration has with administrative expenses is also an indication that, audit fee has little or no impact of the financial position of powerful entities. However auditors are advised to stick to principles that would make them appear independent always, mainly because no matter how powerful an entity is, it cannot survive without the service of an external audit. Hence although, it is who pays the money that controls things, the money maker cannot keep making the money without adhering to the laws and regulation of its environment.

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