

Auditors' Independence and Audit Quality of Money Deposit Banks in Nigeria

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Abstract

Auditors' independence refers to the auditor's ability to be free from influence or predisposition, and consequently the unprejudiced mental demeanor in going with choices all through the review and reporting process. A lack of freedom can significantly diminish the worth of the review administration and report. The purpose of this study was to investigate the association between auditor independence and audit quality in Nigerian money deposit banks (MDBs). The study considered the of ten years (2011-2020), eight money deposit banks were chosen. Data was retrieved from audited financial statements of the selected money deposit banks and evaluated using e-views 10 to determine the outcome. The study discovered that audit rotation and audit fee had a positive and insignificant association with audit quality, whereas audit tenure, board independence, and firm size had a negative and negligible link with audit quality of the quoted MDBs in Nigeria. This study recommends that auditors use a method that adheres to auditing rules and guidelines, or generally accepted auditing practices, in the execution of their duties. This is possible through seminars on current auditing ideas that will be effective in their evaluating practices, so improving the quality of review.

Keywords: Audit quality, Auditor Independence, auditor tenure, auditor rotation

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1. Introduction

A financial report is carefully examined and a qualified reviewer offers their opinion regarding concerns about its reality and fair presentation, the substance of the report may be enhanced (Bassey, Ubi, Olatunbosun, Asi, & Emmanuel, 2020). The rise in business dissatisfaction following reviewers' inappropriate reports stating that an association's budget summary shows a valid and fair opinion has sparked partners' interest in review quality methods (Erasmus & Micah, 2021). According to Enofe, Mgbame, Efayena, and Edegware (2014), the ability of an auditor to protect the interests of customers of fiscal summaries by identifying and exposing misquotes and data inequality among clients of budget reports and the board is correlated with audit quality. This suggests that review quality be apparent when a budget summary is presented.

The requirement for auditor independence is critical to the audit process's development. The auditor's freedom manifests itself in specialized, analytical, and announcing structures (Oladipupo, & Izedonmi, 2013). The ability of an auditor to maintain a goal-oriented and unprejudiced mental demeanor during a review is referred to as independence. It necessitates a disposition of duty apart from the client's benefit. The auditor should maintain a strong expert wariness (Danescu & Spatacean, 2018). The length of the auditor's stay has become a source of concern due to the impediment of the auditor's freedom (Enofe, Mgbame, Okunega & Ediae, 2013). Rahmina and Agoes (2014) present two perspectives on auditor tenure's impact on review quality. As the auditor's client, they may develop a close relationship, becoming obligated to act for executives, which can lower audit quality. Audit rotation can also negatively affect an auditor's independence.

The compulsory rotation of audit partners for a specific client has been implemented to improve audit quality and enhance the quality of general-purpose financial statements. This strategy is proposed by Adebisi and Olowookere (2016) as a safeguard to prevent auditors from becoming too familiar with their clients. Auditor independence is crucial for the audit process's development, and it manifests in specialized, analytical, and announcing structures. However, there are two opposing views on the effects of auditor tenure on review quality. One concerns that auditors may develop a comfortable relationship with clients and become obligated to perform for executives, lowering audit quality. The other view suggests that audit rotation may negatively impact an auditor's independence. This study aims to examine the influence of auditor independence and audit quality on deposit money institutions in Nigeria over a ten-year period using different methods. The sample period was chosen based on data availability, policy homogeneity, a well-coordinated system, and the existence of these institutions prior to the sample period.

2. Review of Literature

Audit quality is determined by an auditor's objectivity, integrity, and independence in their evaluation of financial statement quality (Amahalu & Obi, 2020). Audit quality refers to the auditor's ability to confirm the report's accuracy and address any identified weaknesses. Auditor independence is the ability to make impartial

decisions and decisions, free from the influence of other parties (Alleyne, Devonish & Alleyne 2006; Uche & Ndubuisi, 2021). Two related elements of auditor independence are freedom and apparent independence (Alleyne et al., 2006; Dopuch et al., 2004). Audit independence requires a separate mentality of obligation from the client's benefit, and the auditor should maintain a professional demeanor (Uche & Ndubuisi, 2021). Overall, auditor independence is crucial for ensuring the quality of financial statements.

Auditor independence includes independence both in fact and in appearance. Auditor independence refers to auditors' ability to maintain independent mental attitude while carrying the audit, assessing the findings, and confirming to the audit report (Chung, Kim, & Sunwoo, 2021). The audit independence for this study is focus on audit firm rotation, audit fees and audit tenure.

Audit fees are the fees auditors receive for their services, based on factors such as complexity and experience level. Audit tenure can affect the auditor's independence, as long tenure drives accounting firms to focus on client benefits (Beattie, Brandt & Fearnley, 1999; Quick & Schmidt, 2018). Mandatory rotation, which requires organizations to change auditors, can be through the audit firm revolution or the audit accomplice revolution. This can provide smaller audit firms with opportunities to participate and earn income as market competition increases (Lu, 2005). Mandatory audit rotation can be achieved through the audit firm revolution, which requires organizations to change or turn their CPA firms after a specific timeframe, or the audit accomplice revolution, which requires audit firms to change or change the audit lead accomplice responsible for an audit client (Arel, Brody & Pany, 2005; Raiborn, Schorg, & Massoud, 2006; Orin, 2008).

2.1 Theoretical Review

This concept investigates organizational disputes between directors and owners. According to Berle and Means (1932), with an increase in amazing talent of management, companies are most likely functioning for the benefit of the managers rather than the owners. Jensen and Meckling (1976) explain the fight of side interests between chiefs and investors. Organizational control systems are established in the field to balance the desires of administrators (specialists) with those of owners (chiefs). According to Sanda, Mukaila, and Garba (2005), this hypothesis reduces high ranking representatives' negative mentalities by exposing the deceptive activities in which they typically participated. Agency charges include the costs of all games and working designs used to change supervisors' points and moves.

An external audit evaluates an entity's financial statements to provide evidence supporting the data contained in those statements (Arens et al., 2012). It involves gathering and evaluating evidence to determine the level of concordance between data and measures. Auditing is an efficient process of unbiasedly obtaining and assessing proof about financial activities and events to learn the level of correspondence between statements and established standards (Messier & Douglas, 2008). It is crucial for auditors to be independent of the substance, administration, and any lingering effects. Bahram (2007) emphasizes the importance of review quality in conducting an audit that corresponds to the reasonable assumptions of customers of inspected financial statements. This is an extension of the agency theory, but the theory distributes and organizes the interests of all stakeholders, which include shareholders, government employees, and any third parties, including the community. According to Maher and Anderson (1999), the partner model's emphasis on overcoming challenges of underinvestment is tied to entrepreneurial administrative behavior.

2.3 Empirical Review

Haddad, Anis, and Bouri (2021) investigated the effects of audit boards of trustees. Evaluation on the monetary presentation of Islamic and conventional banks in Switzerland for ten (10) years (2010-2019). This study focused on the cross-sectional technique. This focus on figures indicate that the review panel had a significant impact on conventional banks' liquidity, although a similar impact on Islamic banks' liquidity was clearly ambiguous.

The study by Effendi, Gamal, Purwoko, and Jalil (2021) found that auditor objectivity, autonomy, and capability significantly impact audit quality in public accounting firms in Batam, Indonesia.

Ado, Rashid, Mustapha, and Ademola (2020) conducted a review on financial execution in Nigeria from 2010-2018, finding that audit charge has an immaterial relationship with the ROA of recorded organizations, using a board information approach.

Ahmed and Kwanti's (2020) study on the impact of auditor independence and firm influence on Deposit Money Banks list on the Nigerian Stock Exchange's. The study found that audit independence positively influences audit quality, while audit firm residency negatively affects it.

Eya, Chonoko, and Ajam (2020) conducted a study on the impact of audit quality on Nigerian deposit money banks' implementation from 2009-2019. They found that Auditor Size, Auditor Freedom, and Audit Committee Composition negatively impacted the Return on Asset of selected banks, but the impact was not significant. The study used panel data to analyze the data.

3. Methodology

This study discovered that Auditor Size adversely affects Return on Asset of selected Money Deposit Banks in Nigeria, Auditor Freedom adversely affects Return on Asset of selected Money Deposit Banks in Nigeria, Audit Committee Composition adversely affects Return on Asset and the impact isn't measurably large. The quantitative research strategy was used in this investigation. This study is based on historical data obtained from the annual financial statements and accounts of ten (10) sampled deposit money banks in Nigeria from 2011 to 2020. Because the event under investigation has already occurred, the researcher does not change these variables. The study used a sample size of eight (8) deposit money banks.

The collected data was analyzed using descriptive, correlation, and panel regression methods.

The study's model is expressed in econometric terms.

$$AUDQ_{IT} = \beta_1 AUDTEN_{IT} + \beta_2 AFE_{IT} + \beta_3 AUDROT_{IT} + \beta_4 BIND + \beta_5 FSIZE_{IT}$$

Where: AUDQ denotes audit quality, AUDTEN denotes audit tenure, AFE denotes audit fee, AUDROT denotes audit rotation, BIND denotes board independence, FSIZE denotes firm size, and is constant and slope coefficient.

4. Analysis and Discussion

Table 1: Descriptive Statistics Test Results

| | AUDQ | AUDTEN | AFE | AUDROT | BIND | FSIZE |
|-----------|-------------|-------------|-------------|-------------|-------------|-------------|
| Mean | 0.900000 | 0.712500 | 3.595390 | 0.400000 | 0.538646 | 7.424391 |
| Std. Dev. | 0.301893 | 0.455452 | 1.445900 | 0.704416 | 0.073679 | 1.343361 |
| J.B Test | 181.8930*** | 15.92506*** | 11.71509*** | 49.81499*** | 13.05035*** | 9.773337*** |

Source: Author's Computation (2022)

The mean is the average value of each variable, determined as the total of each variable's data divided by the number of observations. The positive mean values for AUDQ, AUDTEN, AFE, AUDROT, BIND, and FSIZE in table 1 are 0.900000, 0.712500, 3.59539, 0.400000, 0.538646, and 7.424391, respectively.

The standard deviations for AUDQ, AUDTEN, AFE, AUDROT, BIND, and SIZE are 0.301893, 0.455452, 1.445900, 0.704416, 0.073679, and 1.43361, respectively, as shown in table 1. Due to the high values of the variables, AUDQ, AUDTEN, AFE, AUDROT, BIND, and FSIZE data span a wide range of values.

The Jaque-Bera test is used to determine the goodness of fit. The null hypothesis is tested with this test. Skewness and kurtosis, according to the standard theory, are zero. In table 1, Jaque-Bera probability value for AUDQ, AUDTEN, AFE, AUDROT, BIND and SIZE are all significant at 5% level. From the Jaque-Bera probability all descriptive test qualifies for the next stage.

Table 2: Correlation Matrix

| | AUDQ | AUDTEN | AFE | AUDROT | BIND | FSIZE |
|--------|-----------|-----------|-----------|-----------|----------|----------|
| AUDQ | 1.000000 | | | | | |
| AUDTEN | -0.030398 | 1.000000 | | | | |
| AFE | -0.325694 | -0.093920 | 1.000000 | | | |
| AUDROT | 0.193423 | -0.027094 | -0.065543 | 1.000000 | | |
| BIND | -0.303584 | 0.156362 | 0.111119 | -0.099924 | 1.000000 | |
| FSIZE | -0.280725 | -0.126973 | 0.958265 | 0.005222 | 0.056833 | 1.000000 |

Source: Author's Computation (2022)

Table 2 shows that AUDQ has a negative relationship with AUDTEN, AFE, BIND, and FSIZE and a positive relationship with AUDROT, implying that an increase in AUDQ causes a decrease in AUDTEN, AFE, BIND, and FSIZE while a change in AUDQ causes an increase in AUDROT, indicating that the variables are not auto correlated and that the variables have a fair relationship. AUDTEN is negatively related to AUDQ, AFE, AUDROT, and FSIZE, but positively related to BIND. AFE is negatively related to AUDQ, AUDTEN, AUDROT, and BIND, but positively related to FSIZE. AUDROT has a positive relationship with AUDQ and a negative relationship with AUDTEN, AFE, and BIND. AUDQ.BIND has a negative association with AFE, AUDROT, and FSIZE. However, AUDTEN has a positive relationship with BIND while FSIZE has a negative relationship with AUDQ.

Table 3: Hausman Test

| Correlated Random Effects - Hausman Test | | | | |
|--|--|-------------------|--------------|--------|
| Test cross-section random effects | | | | |
| Test Summary | | | | |
| | | Chi-Sq. Statistic | Chi-Sq. d.f. | Prob. |
| Cross-section random | | 4.939888 | 5 | 0.4233 |

Source: Author's Computation (2022)

The point at which the p-value of the Hausman test is not exactly the degree of importance is the decision rule for disregarding the irregular impact result. We accept the irregular impact result of the relapse if the p-value (Hausman test) is greater than 5% significance. The P-value of 0.4233 in table 3 is greater than the 5% level of significance. As a result, the random effect is acknowledged.

Table 4: Random Estimation (Dependent variable: AUDQ)

| Variable | Coefficient | Std. Error | t-Statistic | Prob. |
|-------------|-------------|------------|-------------|--------|
| C | 0.753704 | 0.299905 | 2.513142 | 0.0142 |
| AUDTEN | -0.082823 | 0.036309 | -2.281079 | 0.0255 |
| AFE | 0.004168 | 0.048828 | 0.085352 | 0.9322 |
| AUDROT | 0.119148 | 0.037655 | 3.164229 | 0.0023 |
| BIND | 0.178972 | 0.253225 | 0.706769 | 0.4820 |
| FSIZE | 0.006176 | 0.048728 | 0.126749 | 0.8995 |
| R-squared | 0.171481 | | | |
| F-statistic | 3.021797** | | | |
| D-W Test | 0.682979 | | | |

Source: Authors' computation (2022)

Under the slope coefficient (1 - 4), for AUDTEN(1), a unit change in AUDTEN leads to a negative variation of 0.082823 on AUDQ. As for 2 (AFE), a positive variation is reported. This shows that when all other variables are held constant, there is a unit change in AFE, AUDQ tends to increase at a rate of 0.004168. A positive variation is also observed for 3 (AUDROT). Holding all other variables fixed, a unit change in the company's AUDROT tends to raise AUDQ at a rate of 0.119148. A positive variant is reported for 4 (BIND). Holding all other variables equal, a unit change in the company's BIND tends to boost AUDQ at a rate of 0.178972. In the case of 5 (FSIZE), a positive variation is observed, implying that for every increase in FSIZE, AUDQ tends to rise at a rate of 0.006176.

The P-value of the regression result (see table 4) at 5% level of significance indicates that the variables AUDTEN, AFE, AUDROT, BIND, and FSIZE have an effect. Significant effects on the AUDQ variable of the deposit money banks used in this study (at 5% significance level). The p-values are (0.0255, 0.9322, 0.0023, 0.4820, and 0.8995).

The Durbin Watson test is used to determine the presence of autocorrelation. It is used to determine if the fixed or random test should be accepted. It compares the observation's upper and lower bounds to the estimated DW. The DW is 0.682979 in the table 4 outcome. The upper and lower bounds of the DW table are 1.03 and 1.453, respectively. When the estimated DW does not lie between the upper and lower bounds, this shows that there is no auto-correlation.

5. Conclusion

The study found a negative association between client relationship (AUDTEN) and audit quality (AUDQ) in DMB in Nigeria, with a coefficient value of -0.082823 and a p-value of 0.0255. This indicates that an increase in client relationships could significantly reduce audit quality, as previously observed by Enofe et al (2013) and Ilaboya & Ohiokha (2014).

The study reveals a significant negative correlation between audit fee and audit quality (AUDQ) in Nigerian deposit money banks, contradicting previous hypotheses. The coefficient value of audit fee is -0.004168, with a p value of 0.9322. This suggests that increasing the AFE relationship could significantly impair the audit quality of these banks. This contradicts previous research by Ilaboya and Ohiokha (2014) and Babatolu et al (2016).

The study found that board independence had a positive but minor influence on the audit quality (AUDQ) of Nigerian quoted deposit money institutions, contradicting the initial assumption that AUDQ and BIND would

have a negative connection. This finding is consistent with Enofe et al.'s (2012) findings, suggesting that the variable had a negative but small effect on the audit quality of publicly traded deposit money institutions.

6. Recommendation

Longer audit tenure reduces audit quality, relevant bodies should ensure short audit tenure through due process would help with removing a few impediments to an auditor's freedom, thereby improving auditor quality. Furthermore, the active auditor should have little effect in the commitment of the new auditor to ensure a level playing field. The CBN and other relevant agencies should regularly monitor the activities of audit companies to ensure that their independence is not jeopardized, which might allow for low-quality auditing. Furthermore, International Standard Auditing (ISA) should establish an independent Audit Review Board, which would be responsible for leading practice audits for public entity auditors in order to ensure that audit partners and accounting firms are rotated.

Audit firms should ensure that audit charges are based on expert-recommended benchmarks to ensure their independence and to improve audit quality. The study also suggests that audit businesses should ensure that audit staff members are constantly flipped to avoid similar risks to acquisition.

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