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AUDITOR'S INDEPENDENCE AND RELIABILITY OF FINANCIAL REPORT IN THE BANKING INDUSTRY

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ABSTRACT

The study looked at the impact of audit independence on financial report reliability in the banking industry. The study used an ex post facto research design with data from four publicly traded African banks that are listed on the Nigerian Stock Exchange. The data was examined using multivariate linear regression and spans five years, from 2017 to 2021. The study's findings revealed that listed banks' audit independence has a significant impact on the value relevance of their financial reports; this is reflected in how the amount spent on audit fees by these firms is not seen to have had a significant impact on reported earnings per share, which is a proxy for investor reliance on the financial report. The effect of audit independence on the timeliness of the firms' financial disclosures was also found to be minor. As a result, it is recommended that firms in Nigeria strive to pay the correct audit fee in order to enable the engagement of an audit firm that is independent from influence, thereby increasing the degree of confidence in the reported financial statement and allowing investors to place a high level of trust in the financial reports. Furthermore, managers should collaborate with auditors in an *impartial manner to enable the timely publishing of the firm's financial reports, which would boost and facilitate quick investment decisions because investors consider timely reports to be reliable.*

Keywords: Audit Independence, Timeliness and Value Relevance.

INTRODUCTION

Globalization has a significant impact on global economic growth in general, particularly when it comes to free commerce as part of economic globalization. In both the real and financial sectors, free trade results in the movement of products and services, which has repercussions for businesses as the key actors in the economy. As a result, both governments and corporations must prepare to adapt to the changes that globalization has brought about (Nelson & Devi, 2013). This changes the external business environment, putting pressure on the company to improve its competitiveness in order to benefit from globalization.

The unrestricted flow of commodities and services, as well as a variety of other production factors, has rendered country demographic barriers obsolete in the age of globalization. Investors from diverse countries can invest in other countries that offer greater returns by studying and assessing the pertinent data before making an investment decision. One piece of information that is used is the financial report. It is the outcome of a financial accounting procedure. In this case, investors need to be able to trust the financial statements. Financial statements must be audited before they can be believed, especially if the company is organized as an open limited liability corporation. The shareholders' designated management firm is held accountable in the form of financial accounts for the monies that have been presented to the company's management (Herath & Albarqi, 2017).

Arens, Alvin, Shailer, and Fielder (2011) define auditing as the gathering and evaluation of evidence about information in order to determine and report on the degree of correspondence between the information and established criteria. Messier (2008), who asserted that auditing is a systematic process of objectively obtaining and evaluating evidence regarding assertions about economic actions and events in order to determine the degree of correspondence between those assertions and established criteria and communicating the results to interested users, stated the same thing. The amount of study into audit independence has expanded dramatically over the last decade, due to a variety of circumstances. In recent years, the adoption of standard accounting methods by several Nigerian corporations has resulted in the independence of auditors being protected, resulting in a more respectable auditing profession (Asien, 2014). Furthermore, to ensure that auditors' reports provide the necessary level of comfort to investors whose funds are invested in the companies, auditors have been subjected to undue pressure from stakeholders, which is problematic. Furthermore, the global financial crisis has put a lot of corporations under a lot of pressure to cut costs, which has harmed audit quality because firms are less willing to pay the needed charge for audit function, which ensures an audit free of undue influence (Asthana, Khurana, & Raman, 2018). This has had a significant impact on audit independence, most likely with the goal of sharing the cost-related burden. However, in the current economic climate, external auditors are faced with more difficult decisions in areas such as determining going concern, asset impairments, and fair valuations, putting the accuracy of the firms' financial reports in jeopardy. This invariably increases the time spent on an audit, which is predicted to increase the timeframe in which financial reports are provided to shareholders, reducing trust in the financial report since it does not meet the timeliness objectivity of a quality financial report. The fact that corporate administration employs, fires, and pays external auditors below the Institute of Chartered Accountants of Nigeria's (ICAN) minimum professional scale of fees creates a possible difficulty for independent auditors (Ndubuisi & Ezechukwu, 2017). Financial reporting's major goal is to offer high-quality financial information on economic entities that may be used to make economic decisions. Investors and other stakeholders rely on high-quality financial reporting to make investment, credit, and other decisions, according to the International Accounting Standard Board (IASB) (2008). As it is reported in the published financial report of firms, it is expected to provide a timely and reliable input to potential investors, shareholders, creditors, employees, management, financial analysts, regulators, and other stakeholders for efficient economic decisions. Another important variable of financial reporting that is usually used as a yardstick of financial reporting quality is its value relevance and timeliness.

Statement of the Problem

According to Bahram (2007), it is critical to undertake work with due regard for audit independence in order to carry out an audit that meets the reasonable expectations of users of audited financial statements. The audit firm and auditor must not be jeopardized, and they must not sacrifice quality in the pursuit of financial gain. Bahram (2007) goes on to say that the background of the audit independence and quality control reforms is the erosion of trust in financial reporting and auditing caused by corporate failures and accountants' failures in a number of countries, and that this is an issue that should be investigated in the context of Nigeria as an emerging market. As a result, many governments have increased regulation of the profession in an attempt to restore public and investor trust in corporate financial reporting. While financial disasters have not occurred in every country, they have had a substantial impact on the worldwide regulatory environment, necessitating action.

According to Arens, et al. (2011), the value of auditing is greatly influenced by the public's view of auditor independence. Enofe, Nbgame, Okunega, and Ediae (2013) have the same opinion, stating that when auditor independence increases, audit quality rises as well. These researchers have focused on audit independence and quality of audit rather than the reliability of firms' financial report. As a result, we intend to conduct our own study to reflect the Nigerian listed banks' perspective in line with the value relevance and timeliness of their financial report as a proxy for the reliability of firms' financial report to see if the findings of this study will be consistent with those of previous studies and contribute to knowledge.

Objectives of the Study

The study's overall objective is to look into the influence of audit independence on bank financial report reliability, but it also has particular goals such as:

i. Look into the effect of audit independence on the timeliness of listed commercial banks' financial reports in Nigeria.
ii. Determine the impact of audit independence on the value relevance of financial reports from listed commercial banks in Nigeria.

LITERATURE REVIEW

Concept of Audit Independence

Bahram (2007) describes the notion of auditor's independence as the auditor's ability to maintain an objective and impartial mental attitude throughout the audit. Also, Rick, Roger, Arnold, and Philip, (2004) defines the independence of the auditor as having a position to take an unbiased viewpoint in the performance of audit tests, analysis of results, and attestation in the audit report. Furthermore, Arens, et.al (2011) explains that audit independence requires an attitude of responsibility separate from the client's interest. The auditor must maintain a professional skepticism that is healthy. Based on the foregoing, the auditor's independence can be defined as the auditor's capacity to maintain a mental attitude objectively and impartially in the client's best interests while conducting the audit, interpreting the results, and attestation in the audit report without being influenced. Arens et.al (2011) explains that the independence of the auditor is divided into two parts; independence in mind and independence in appearance. Independence of mind refers to the state of mind of the auditor, which allows the audit to be conducted objectively. The concept of mental independence parallels a long-standing need that members be physically independent. The appearance of independence is the product of other people's interpretations of it. If auditors are truly impartial, but users assume them to be client supporters, the audit function loses a lot of its value.

Furthermore, according to Mautz and Sharaf (1993), auditor independence is comprised of three dimensions: programming independence, which is defined as freedom from control or undue influence in the selection of audit techniques and procedures, as well as the scope of their application. Within the overall parameters of the engagement, the auditor must have the freedom to construct his own program, both in terms of steps to be included and the amount of work to be accomplished. Investigative independence refers to the lack of control or undue influence over the areas, activities, personal relationships, and management policies under investigation. This necessitates the auditor's access to all legitimate sources of information; and reporting independence, which entails freedom from control or undue influence in the statement of facts revealed by the examination, as well as the expression of recommendations or opinions as a result of the examination.

Audit Independence and Reliability of Financial Reports

The immediate duty of audit independence, according to Ndubuisi et al., (2017), is to serve the audit. It improves the audit's effectiveness by ensuring that the auditor will plan and carry out the audit objectively. As a result, the greater purpose of audit independence, as well as its goal, must be found. Furthermore, according to Mitra, Deis, and Hossain (2009), the immediate goal of the audit is to improve the dependability of information used for investment and credit choices, and audit independence is critical to that goal. Improvements in corporate disclosure reliability lower the likelihood that an investor or creditor would make a poor judgment based on erroneous or otherwise inadequate information. Every time an investor or creditor utilizes information to analyze the economic risk of a possible investment, this risk information is there. The higher the quality of the data investors and creditors use to analyze economic risk, the more likely they are to make sensible judgments. In other words, their chance of losing knowledge is decreased.

Investors and creditors' perceptions of information risk are reflected in the cost of capital for businesses. Reliable corporate disclosure benefits both providers and users of capital. It is well established how audit independence improves the trustworthiness of information utilized in investment and credit decisions (Knechel, Krishnan, Pevzner, Shefchik & Velury, 2012). Deterrence, detection, and verification are used for the audits. Knowing that auditors are on their way deters managements who are prone to misrepresenting financial results; auditors discover the vast majority of distortions that do occur; and selective testing of undistorted data gives evidence of its dependability. According to Asthana, Khurana, and Raman's research (2018), auditing enhances the credibility of financial data that investors use to make decisions. Earnings reported that are of value to investors are affected by more reliable information. If the metrics analysts use more accurately represent the substance of the banks' financial performance, earnings per share is more likely to indicate corporate earning potential. If financial reports reflect corporate earning power, investors are more likely to put their money into the most productive businesses.

The auditor's contribution is sometimes defined as providing credibility to the timeliness of financial reports, which is an essential side effect of auditing, but it is not the heart of the auditor's contribution because Management Corporation is also required (Carmona, Momparler, & Lassala, 2015). To repeat, the essential contribution is the impact of the audit process on the reliability of the data used to make judgments. There would be no meaningful basis for investor confidence in the information without increased reliability, and earnings would have less of a resemblance to a firm's earning capability, and reports would be late. Auditors would be great cheerleaders for their clients if their sole or primary goal was to persuade investors to engage in transactions notwithstanding potential management bias in the financial statements. Auditing and spreading corporate information are two of those costs, and audit independence is another. The lower the cost of competent auditing, the greater its net contribution to financial report reliability. Compliance, quality controls, and protections are among the expenses of audit independence, as are compensation for opportunities missed due to adherence to restrictions, and incremental service costs faced by clients who are deprived of service providers' economies of scale and breadth. A usefully stated objective of audit independence would capture both the fee and the benefit side of the contribution to the investors (Eko, 2012).

Theoretical Framework

This research is based on the Signaling theory, which is a relevant theory in the investigation of financial report dependability.

The Signaling Hypothesis: A situation in which one party transmits information to another is referred to as signaling. Jensen and Meckling (1976) describe signal as a high-type manager's action that would be irrational if the management were low type. According to Scott (2009), manipulative accounting may be used for signaling because management may try to smooth the report so that it transmits the desired information to the firm's other stakeholders. More specifically, the author argued that manipulative accounting is utilized to disclose persistent earnings power, which is regarded as a warning because earnings reversal can make manipulating and reporting greater earnings that can be maintained highly costly for a low-type manager. This theory is related to audit practice in the sense that it raises awareness among auditors and researchers of the importance of conducting a quality audit and for firms to pay the appropriate fee for reasonable assurance services that will assure the quality of a firm's financial report.

Review of Empirical Studies

Several studies have been conducted on the effect of audit independence on reliability of firms' financial report using data from both developed and emerging economies. Some of these studies are reviewed below:

Okolie (2014) investigates how auditor independence affects earnings management. They used a sample of 57 Nigerian publicly traded companies from 2006 to 2011. According to the findings, audit fees have a negative correlation with discretionary accruals. AbdulMalik et al., (2016), who investigated the influence of audit fees on financial reporting quality in Nigeria, agree. The data came from 89 publicly traded firms' annual reports from 2008 to 2013. They demonstrate that audit costs have a large detrimental impact on discretionary accruals. They also propose that the high fees given to Nigerian auditors may not jeopardize their independence because it minimizes the size of irregular accruals. Furthermore, a recent study by Abdul-Rahman, et al., (2017), which looked at the relationship between audit fees and audit quality in Nigeria, found that audit fees are positively and significantly associated to audit quality. The study postulated the following based on the above argument: H1 The audit charge has a considerable favorable link with the quality of financial reporting.

In the United States, Asthana et al. (2018) investigate fee competition among the Big 4 auditors and audit quality. They reveal that in the highly concentrated US audit market, fees contests are seen as an important strategy for improving audit quality. Knechel et al., (2018) investigate the effects of broad trust and community participation on audit fees in various nations around the world. They show that countries with higher levels of trust and community cooperation are more likely to spend money on a thorough audit and request more auditing services. They suggest that countries that have a better level of trust and community collaboration pay higher audit costs in order to seek more guarantee. This suggests that countries with a higher level of extensive trust or public collaboration pay a higher price for auditing services and are thus willing to pay higher audit fees.

In Malaysia, Al-Dhamari et al. (2018) investigate the relationship between related party transactions and audit fees. According to them, audit fees for firms that engage in related party transactions, such as the acquisition and sale of assets, goods, and services, are high. This supports Al-Rassas et al., (2015) findings on the impact of external audit quality and audit committee characteristics in Malaysia. They found a negative and substantial association between audit fees and discretionary accruals. This implies that in Malaysia, higher audit fees are linked to lower discretionary spending and improved financial reporting quality. Okolie (2014) investigates how auditor independence affects earnings management. They used a sample of 57 Nigerian publicly traded companies from 2006 to 2011. According to the findings, audit fees have a negative correlation with discretionary accruals. AbdulMalik et al., (2016), who investigated the influence of audit fees on financial reporting quality in Nigeria, agree. The data came from 89 publicly traded firms' annual reports from 2008 to 2013. They demonstrate that audit costs have a large detrimental impact on discretionary accruals. They also propose that the high fees given to Nigerian auditors may not jeopardize their independence because it minimizes the size of irregular accruals. Furthermore, a recent study by Abdul-Rahman, et al., (2017), which looked at the relationship between audit fees and audit quality in Nigeria, found that audit fees are positively and significantly associated to audit quality. The study postulated that: H1 Audit fee has a positive significant association with financial reporting quality, based on the preceding reasoning.

METHODOLOGY

The purpose of this study is to look into the impact of audit independence on the financial report credibility of companies in Nigeria, notably listed commercial banks. The study used an ex post facto research design and Multi-variant ordinary least square (OLS) regression to analyze data from the annual financial statements of four out of seventeen listed commercial banks (First Bank PLC, Guarantee Trust Bank PLC, Eco Bank PLC, and United Bank for Africa PLC) on the Nigerian stock exchange market from 2017 to 2021, a five-year period; the reason for this is that these are banks that operate across African borders, not just in Nigeria.

Model Specification

This study formulates the following model to be used by the researcher in the investigation.

$Ve = á + â_1 AI_{it} + U_{it}\, TM_{it} = á + â_1 AI_{it} + U_{it}$

Where;

á = Constant

AI = Audit Independence (Log of audit fee; proxy for audit independence)
VR = Value Relevance (Reported Earnings per share of the firm at a time as proxy for value relevance of firms financial statement)
TM = Timeliness of Financial report (Reported number of days between when the auditor sign the financial report and when it is published) it= Cross-sectional (i) at time (t)
U = Error term used in the model.
$\hat{a}_1$= Beta coefficient of the independent variable.

Decision Rule: Accept the null hypothesis if the calculated value is greater than the significant level of 0.05.

RESULTS

Data Presentation and Analysis Data Validity Test

In order to ensure that the results are robust, the Pure Error statistic was computed as shown in table 2 below. The Pure Error statistic for the two models specified stood between at 0.00 which is not above the standard of 0.05 indicating the absence of auto-correlation (Gujaratti, 2004); this substantiates the absence of auto-correlation problem among the explanatory variable thus enabled us to go ahead with the regression analysis.

Descriptive Statistics

	N	Minimum	Maximum	Mean		Std. Deviation
	Statistic	Statistic	Statistic	Statistic	Std. Error	Statistic
AI	20	7.40	8.70	8.2594	.09732	.43521
VR	20	.16	5.67	1.7055	.38061	1.70213
TM	20	1.70	2.00	1.8727	.02440	.10910
Valid N (listwise)	20					

Table1 presents the descriptive statistics of all the variables. N represents the number of observations and therefore the number of observations for the study is 20.

Audit Independence (AI) reflects a mean of 8.2594 and a standard deviation of 0.0.43521, it has a minimum value of 7.40 and a maximum value of 8.70. Value Relevance (VR) reflects a mean of 1.7055 and a standard deviation of 1.70213, it has a minimum value of 0.16 and a maximum value of 5.67. Timeliness (TM) of financial reports reflects a mean and deviation of 1.8727 and 0.10910 respectively. It also shows a minimum and maximum value of 1.70 and 2.00. This various means and deviation shown by the variables shows the level of variation amongst the variables in the industry.

Regression of the Estimated Model Summary

This section of the chapter presents the results produced by the model summaries for further analysis. Thus:

Univariate Tests

Dependent Variable	Source	Sum of Squares	df	Mean Square	F	Sig.
VR	Lack of Fit	41.634	17	2.449	.	.
	Pure Error	.000	1	.000		
TM	Lack of Fit	.203	17	.012	.	.
	Pure Error	.000	1	.000		

Tests of Between-Subjects Effects

Source	Dependent Variable	Type III Sum of Squares	Df	Mean Square	F	Sig.
Corrected Model	VR	13.414[a]	1	13.414	5.800	.027
	TM	.023[b]	1	.023	2.014	.173
Intercept	VR	10.670	1	10.670	4.613	.046
	TM	.337	1	.337	29.793	.000
AI	VR	13.414	1	13.414	5.800	.027
	TM	.023	1	.023	2.014	.173
Error	VR	41.634	18	2.313		
	TM	.203	18	.011		
Total	VR	113.222	20			
	TM	70.366	20			
Corrected Total	VR	55.048	19			
	TM	.226	19			

a. R Squared = .244 (Adjusted R Squared = .202)
b. R Squared = .101 (Adjusted R Squared = .051)

Table 2, presents the regression result between AI and VR, TM. From the model summary table above, the following information can be distilled.

H_{o1}: Audit Independence has no significant effect on the value relevance of listed banks financial reports in Nigeria.

The R^2 value stood at 0.244.The R^2 otherwise known as the coefficient of determination shows the percentage of the total variation of the dependent variable (VR) that can be explained by the independent or explanatory variable (AI). Thus the R^2 value of 0.244 indicates that 24.4% of the variation in Value Relevance (Reliability of financial report) of the listed firms can be explained by a variation in the independent variable AI (Audit Independence) while, the remaining 75.6% (i.e. 100-R2) could be accounted by other variables not included in this model.

The adjusted R^2 of 0.202 indicates that if the entire population is considered for this study, this result will deviate from it by only 0.042 (i.e. 0.244 – 0.202). This result shows that there is a deviation of the sample examined and the total population by 4.4%. The table further shows the F of 5.800.

Given the stated null hypothesis above for model 1 and considering the outcome of the regression result carried out in line with the decision rule earlier stated. The study accepts the alternative hypothesis and rejects the null hypothesis since the calculated significant level of 0.0.027 (AI) is less than the accepted significant level of 0.05.

H_{o2}: Audit Independence has no significant effect on the Timeliness of listed banks financial reports in Nigeria.

The R^2 value stood at 0.101.The R^2 otherwise known as the coefficient of determination shows the percentage of the total variation of the dependent variable (TM) that can be explained by the independent or explanatory variable (AI). Thus the R^2 value of 0.101 indicates that 10.1% of the variation in Timeliness (Reliability of financial report) of the listed firms can be explained by a variation in the independent variable AI (Audit Independence) while, the remaining 89.9% (i.e. 100-R2) could be accounted by other variables not included in this model.

The adjusted R^2 of 0.051 indicates that if the entire population is considered for this study, this result will deviate from it by only 0.050 (i.e. 0.101 – 0.051). This result shows that there is a deviation of the sample examined and the total population by 5.0%. The table further shows the F of 2.014.

Given the stated null hypothesis above for model 2 and considering the outcome of the regression result carried out in line with the decision rule earlier stated. The study rejects the alternative hypothesis and accepts the null hypothesis since the calculated significant level of 0.173 (AI) is greater than the accepted significant level of 0.05.

CONCLUSION AND RECOMMENDATIONS

Based on the findings of this study and the testing of the two research hypotheses previously formulated in the study, the researchers have concluded that audit independence by listed banks has a significant impact on the value relevance of their financial report; this is reflected in how the amount spent on audit fees by these firms is seen to have had a significant impact on the reported earnings per share, which is a proxy for reliance on the financial statements. The effect of audit independence on the timeliness of the firms' financial disclosures was also found to be minor.

As a result, it is recommended that firms in Nigeria strive to pay the correct audit fee in order to enable the engagement of an audit firm that is independent from influence, thereby increasing the degree of confidence in the reported financial statement and allowing investors to place a high level of trust in the financial reports. Furthermore, managers should work independently with auditors to ensure the timely publishing of the firm's financial reports, which would boost and facilitate rapid investment decisions because investors consider timely reports to be reliable.

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