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ARE THERE FACTORS INFLUENCING AUDITORS' INDEPENDENCE IN LISTED FIRMS? EMPIRICAL ANALYSIS FROM NIGERIA

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Abstract
Quest for a potent measure of audit independence in the light of the increasing collapse of firms after an external auditor report informed the rationale behind this research. The study investigated the factors driving auditor independence in Nigeria using data from a sample of eighty eight (88) listed firms in the period 2015 to 2019. The Correlation statistic and dynamic panel least squares method. The result indicates that audit committee independence, managerial ownership and audit tenure were significant and exerted a favourable link on auditor independence. Board gender diversity was negative on auditor independence. The stances of the research is that audit committee independence, managerial ownership and audit tenure are key drivers of auditor independence of listed firms in Nigeria.

Key words: Auditor Independence, Audit Tenure, Audit Committee Independence, Board Gender Diversity, Beneish M-Score

1. Introduction

The incessant corporate scandals and collapses of firms after audited annual reports have continued to elicit the attention of researchers and scholars to reinvestigate independence of an auditor. Ali and Nesrine (2015) emphasized that in recent time, auditor independence has become more researched given the financial scandals against firms. For instance, the financial scandals against firms such as Enron, (US) WorldCom, Parmalat (Italy), Nortel, (Canada), Onetel (Australia), Lehman Brother and Merrill Lynch, American International Group (AIG), Oceanic and Intercontinental banks (Nigeria) after the audited financial statements bring to fore the need to re-examine factors driving independence of external auditors. Generally, an audited financial statement is a conduit for a reliable and transparent information on the true health of a firm to shareholders, potential investors and other stakeholders in general. It serves as the basis of undertaking informed decision and policies formulations by the myriad users (Adeyemi & Okpala, 2011).

An external auditor is perceived to be independent in carrying out audit assignments if the auditor is able to unravel the depth of material misstatements and manipulated accounting numbers in the annual reports in a bid to reflect high audit quality. Tagesson, Sjodahl, Collin, Olsson and Svensson (2017) posit that auditor independence is a determinant of quality audit report. Conventionally, there is a theoretical notion that quality of an audit report is premised on amount the external auditor is remunerated with (Salawu, 2017). Audit fee is perceived to be a primary factor in assessing the external auditor independence in companies. Despite these notions, several adverse effects such as the scandals in and collapse of firms portrays that audit fee is not a reliable driver of auditor independence. In consonance with this, Li and Lin (2005) report that high fees paid by a firm to its external auditor tends to increase the economic bond between the auditor and the client firm and may impair the expected independence of the auditor.

Salawu (2017) states that despite the importance and centrality of independence to auditing profession, auditors in contemporary times seek to expand their profit while at the same time strive for independence and these double pursuits tend to pose a serious challenge to audit practices. The SEC (2000) report indicates that four big 4 audit firms earned 50% of their income from management and consulting field which was only 13% as at 1981. Mitchell and Sikka (2002) noted that the pursuit of profits inhibits auditors in providing reasonable assurance that the financial statements are free from material misstatement and manipulations.

Presumably, for external auditor to be truly independent, such an auditor should be able to unravel the level of manipulated accounting numbers in the financial statements and exercise an acceptable level of materiality judgment in favour of the client firm. In accounting and audit literature, assessment and disclosure of manipulated accounting numbers as well as exercising critical judgment over materiality in the financial statements are an effective measure of auditor independence (Beneish, 1990; Messier, Martinov – Bennie & Eillifsen, 2005). Beneish (1990); Messier, Martinov – Bennie and Eillifsen, (2005) were the early scholars to measure manipulated accounting numbers and level of materiality using Beneish M-Score index and auditor materiality judgment. Since the development of the Beneish M-Score index as a measure of auditor independence, there are no researches which have applied it in developing countries, especially in the Nigeria context, thus creating a gap in literature.

Auditor independence does not occur without the influence of certain factors (Li & Lin 2005). Salawu (2017) opines that factors such as board gender diversity, audit committee independence, managerial ownership and auditor tenure likely common drivers of auditor independence in contemporary times. Researches on board gender diversity are gradually gaining ascendancy in the Nigeria clime. However, there appears to be a neglect of policy thrust gear towards promoting gender diversity at both macro and micro levels in Nigeria. The exclusion of potential and capable women directors on the board may contribute to an adverse effect on the strategic management of firms, poor monitoring of performance and independence of the statutory auditor. This argument is based on the notion that women are generally believed to be more ethical and committed to company goal, punctual in board and committee meetings compared to the ‘’men folk’’ in firms.

The audit committee is a pivotal governance structure in ensuring the independence of a statutory auditor in firms. The audit committee is germane in matters relating to the appointment of external auditor of a firm. Audit committee owns a fiduciary a duty to shareholders and other stakeholders to be independent, discusses with and keep external auditors abreast of the need for independence and objectivity in assigned duties. In promoting this, the audit committee meets with the external auditor on a frequent basis without board of directors' knowledge and discusses with the auditor some contentious issues that may have occurred in the course of the audit exercise. In the context of Nigeria, there seems to be lack of a body of empirical evidence on association between independence of audit committee and external auditor independence, thus leading to a vacuum to be addressed in this study.

Besides the effectiveness and independence of the audit committee and board gender diversity, the interest of the managers by way of investment and ownership could contribute to external auditor's independence. If managers have stakes in a firm through investments shareholding, there is the tendency that they would be committed to ensuring that the audited financial statements reflect a true and fair view. In the view of Kane and Velury (2004), increase in management ownership in firms plays a paramount role and influence over the external auditor in the financial statements of companies. Tagesson, et al (2017) opine that while audit tenure may improve auditor independence, there are opposing views that it is not a sufficient condition for it. The belief is that independence is commonly gained at the expense of the auditor's knowledge of business structure and routine.

2. Empirical Review

Auditor independence is the tendency of an external auditor to overcome undue influence from board of directors in the course of audit engagement in order to enure that the professional integrity of the auditor is not negatively affected (Ali & Nesrine, 2015). The major task of a statutory auditor, among others is to duly express an unqualified opinion on whether or not a firm's financial reports are devoid of accounting manipulations and material misstatements (Salawu, 2017). Beneish (1990); Messier, Martinov – Bennie and Eillifsen, (2005) emphasized that an external auditor is independent if the auditor is objective, able to discover and reveal manipulations of accounting numbers in the financial statements of firms. Koschtial (2013) employed Beneish model to ascertain accounting number manipulations. The study outcome shows that highly manipulated firm where auditors issue unqualified audit opinion are susceptible to bankruptcy.

On the empirical fronts, Mwangi, Oluoch, Muturi and Memba (2017) conducted a study on the effect of gender diversity on quality of financial reporting in non- commercial state owned corporations in Kenya. The result showed that the presence of adequate women and non-executive directors in the audit committee enhance the chances of the external auditor to be objective and independent in expressing opinion. Ittonen, Miettinen and Vahamaa (2009) reported that companies with female directors are likely to reduce the inherent risk of misstatements. Mwangi et al (2017) explained further that the results of Ittonen et al (2009) have implications for external auditors. Huse and Solberg (2006) established that women directors are better prepared for board meetings compared to men directors and that this results in improved behaviour and effectiveness. They posit that these benefits are also achieved by audit committee with women membership.

Kuang and Chen (2011) added to this when they state that a feminine presence on the Chinese corporate board is closely correlated with demands for higher quality external auditing. Xiang and Qin (2015) argued that having women on the audit committee can significantly increase audit quality of financial reporting and the efficacy of internal control, thus promoting audit quality in Chinese firms just like in every other country. Sun, Liu and Lan (2011) empirical study revealed that the representation of women on fully independent audit committee exert significant effect on audit quality.

In Nigeria, fewer bodies of empirical evidence have considered the influence of audit committee independence on external auditor independence in listed firms with mixed empirical results. For example, studies conducted by Iyengar, Land and Zampelli (2010); Jian and Anandarajan (2009); Chang and Sun (2010); Berthelot (2012) on the relationship between audit committee independence and audit quality are inconclusive. Gosh (2009); Chang and Sun (2010) report that an effective audit committee independence is favourably associated with audit independence in the post-Sarbenes- Oxley studies. Carcello, Hollingsworth, Klein and Neal (2006) find that independent audit committee members with financial expertise are effective at enhancing audit independence. Petra (2007) finds no relationship between independent audit committee members with audit independence. Sun (2013) also finds an adverse and non-significant effect of independence of the audit committee on audit quality.

Majiyebo, Okpanachi, Nyor, Yahaya and Mohammed (2018) investigated audit committee independence, size and audit quality of listed deposit money banks in Nigeria. They used a sample of 15 banks in the period 2007 to 2016. The research outcome shows that audit committee independence has a negative but insignificant effect on auditor independence of listed deposit money banks in Nigeria. If audit committee members are independent, objective, possess sound and adequate accounting knowledge and expertise, and they are properly trained in international financial reporting standards (IFRSs), assuming all other factors are held constant, there is the likelihood that they can positively influence auditor independence and the quality of audit report.

Mohamad, Sori, Mohd and Mohamad (2007) examined the relationship between audit committee independence and external auditor independence. The finding revealed that auditor independence can be strengthened by a committed audit committee that is independent and uninfluenced by board of directors in a company. Sharma and Iselin (2012) carried out a study on the effect of independent audit committee characteristics on auditor independence in companies. After controlling for other corporate governance variables, the independence of the audit committee was seen to be a major enhancer of external auditor independence. In the same vein, Zhang, Zhou and

Zhou (2007) research indicates that an association exists between audit committee independence and external auditor independence. Baotham and Ussahawanitchakit (2009) empirical study result showed that audit committee independence has a positive relationship with audit quality; and audit quality has a positive correlation with audit credibility.

The study dealing with the association between managerial share ownership and auditor independence in firms is still inconclusive. The study by Lenox (2005) for instance reported a negative association between managerial ownership and audit independence while Eiya and Ogbeide (2014) found that managerial ownership determined audit independence and was statistically significant. Abdullah (2008) argued that few empirical studies investigated the nexus between managerial ownership and how they impact on auditor independence. Qomariah (2013) study pointed out that the influence of managerial ownership is negative on audit quality. This suggests that managers' ownership in firm impacts on audit quality (auditor independence). Kantudu and Samaila (2015) study revealed that managerial share ownership is significant at determining quality financial reporting and audit quality of listed companies in the oil & gas sector of Nigeria.

Ramadan (2015) research indicates that managerial shareholding is inversely related with audit quality and by extension auditor independence. Ogbonnaya, Ekwe and Ihendinihu (2016) study showed that managerial ownership exerts a positive and significant impact on audit quality. In the same vein, Fei (2015) reported that managerial ownership has a negative and significant effect on audit quality (auditor independence). Lenox (2005) investigated the relation between auditor independence and management ownership in the United Kingdom. The author found a negative correlation between managerial ownership and auditor independence.

Mgbame, Eragbhe and Osazuwa (2012) investigated the relationship between audit tenure and auditor independence in Nigeria. They used the binary logit estimation technique to analyze the data. They found a negative relationship between audit tenure and auditor independence in the listed companies in Nigeria. Salawu (2017) investigated factors influencing auditor independence among listed companies in Nigeria between 2005 and 2013. Descriptive statistics and the Generalized Method of Moment (GMM) were employed to analyze the data generated from 65 listed financial and non-financial companies in the Nigerian Stock Market. Additionally, preliminary tests like Sargan test, Arrelano-Bond Serial Correlation tests, among others were carried out on the data. Finding from the study shows that audit tenure had significant impact, which can impair auditor independence in Nigeria. Enofe, Mgbame, Okunega and Ediae (2013) assesses the association between audit quality and auditor independence. The data for the research was generated from 20 companies in the Nigerian Stock Market. They used ordinary least squares regression method to analyze the data. They concluded in the study that the longer the audit tenure, the higher the auditor independence. Geiger and Raghunandan (2002) point out that auditors with longer tenure are more likely to be independent.

3. Materials and Methods

This study investigates auditor independence determinants among firms in Nigeria. Eighty-eight listed non- financial firms were selected using the simple random sampling technique in the period 2015 to 2019. This represents four hundred and forty (440) firm- annual observations. Correlation matrix and the dynamic panel estimation method were used to analyze the data.

$$Audind_{it} = \beta_0 + \beta_1 Audind_{it-1} + \beta_2 Mgo_{it} + \beta_3 Auditten_{it} + \beta_4 Bgd_{it} + \beta_5 Audcind_{it} + \beta_6 \sum control\ variable_{it} + \varepsilon_{it} \ldots\ldots\ldots\ldots\ldots\ldots\ldots\ldots 1$$

Where, $Audind_{it}$ = Auditor independence of i firm in t period; Mgo_{it} = managerial ownership of i firm in t period; $Auditten_{it}$ = Audit tenure of i firm in t period; Bgd_{it} = Board gender diversity of i firm in t period; $Audcind_{it}$ = Audit committee independence of i firm in t period; i = Individual firm in the sample size; t = Period the study covers; ε = Error term acting as a surrogate in the models; β_0 = Intercept; $\sum Control\ variable_{it}$ = consists of firm size.

Table 1: Operationalization of Variables

S/N	Variables	Type of Variables	Adopted Measurements	Sources
1.	Auditor Independence	Dependent variable	Beneish M-Score index	Beneish (1990); Messier, Martinov – Bennie and Eillifsen (2005).
2.	Beneish M-Score	Dependent variable	Measured using eight financial ratios weighted by coefficients to identify whether a company has manipulated its profits. The eight variables are then weighted together in the formula below. Beneish concluded that if a company scored greater than -2.22 (i.e. a less negative or positive number) there was a likely probability of profit	Beneish (1990); Messier, Martinov – Bennie & Eillifsen (2005). Beneish (1990)

			manipulation.	
3.	Board Gender diversity	Independent variable	Measured using BLAU index method	Ogbeide (2018)
4	Audit Tenure	Independent Variable	Length of auditor-client relationship: '1' if 3 yrs+ & '0' if otherwise.	Enofe, Mgbame, Okunega and Ediae (2013).
5.	Managerial Ownership	Independent Variable	Measured as the number of share owned by managers divided by total outstanding shares in the company	Eiya & Ogbeide (2014)
6.	Audit committee independence	Independent Variable	Number of independent directors in the audit committee divided by audit committee size	Salawu (2017
7.	Firm Size	Independent Variable	Total Assets of the firm	Ogbeide 2018)

Source: Researchers' compilation, 2020.

4. Empirical Analysis

Table 2: Correlation Matrix

	A	B	C	D	E	F
A	1.000					
B	0.015	1.000				
C	0.054	-0.007	1.000			
D	0.008	0.1967*	0.027	1.000		
E	0.008	0.0761*	0.0704*	0.1532*	1.000	
F	0.009	-0.039	0.002	0.046	0.033	1.000

The letters in table 2 represents the variables in the construct. A represents auditor independence, proxied with Beneish-M-Score index; b represents managerial ownership; c represents audit tenure; d represents board gender diversity; e represents audit committee independence while f represents firm size. Table 2 indicates absence of harmful multicollinearity between the factors influencing auditor independence. The association between managerial ownership and auditor independence is positive (r= 0.015). Board gender diversity is positively correlated with auditor independence (r= 0.008). Audit tenure is weak and positively related with auditor independence (r=0.054); audit committee independence is positively correlated with auditor independence (r=0.008). The association between the control variable, firm size is weak and positive in the sampled firm. The correlation between auditor independence and the key explanatory variables suggests these variables are key drivers of auditor independence in listed firms in Nigeria.

Table 3: Regression Result

	(1)	(3)	(4)	(5)	(6)	(7)
	POLS	FE	DGMM1	DGMM2	SGMM1	SGMM2
Bms	0.687***	0.179	0.185	0.072***	0.273	0.268***
	[0.11]	[0.20]	[0.38]	[0.03]	[0.17]	[0.02]
Mgo	0.004	0.004	0.021	0.002	0.010	0.006***
	[0.00]	[0.01]	[0.02]	[0.00]	[0.01]	[0.00]
Auditten	0.023	0.013	-0.143	-0.005	0.025	0.038***
	[0.03]	[0.10]	[0.31]	[0.04]	[0.08]	[0.01]
Audcind	2.756***	11.212***	4.569	0.455	2.172**	0.599***
	[0.89]	[4.10]	[6.36]	[1.38]	[0.94]	[0.36]
Bgd	0.036***	0.027	0.018	0.027	0.025	0.036*
	[0.01]	[0.03]	[0.08]	[0.02]	[0.03]	[0.01]
Fsize	-0.248***	-0.931***	-3.195***	-1.187***	-0.486***	-0.341***
	[0.07]	[0.25]	[0.80]	[0.29]	[0.10]	[0.04]
Constant	265.711***	267.072***			241.280***	262.878***
	[1.67]	[3.00]			[8.26]	[18.12]
Breusch and Pagan						
Hausman test		76.82***				
Heteroscedasticity (Modified Wald test)		8.5e+07***				
Autocorrelation (Wooldridge test)		25.716***				
Observations	825	660	660	660	825	825
No. of instruments			64	64	102	102
No. of groups		165	165	165	165	165
Arellano-Bond: AR(1)			0.028	0.260	0.001	0.035
Arellano-Bond: AR(2)			0.300	0.295	0.039	0.158
Hansen test (p-val)				1.000		0.851

Standard errors in brackets
* $p < 0.1$, ** $p < 0.05$, *** $p < 0.01$

Table 3 relates the effect of the selected explanatory variables on auditor independence of the firms in Nigeria. The AR (2) specification test and Hansen test indicate the model is economically insignificant and remained valid. This implies the model was properly specified and there is absence of second order correlation in the regression result. Two period lag of Beneish-M-Score (auditor independence) is positive and statistically significant. Managerial ownership exerted positive and significant effect on auditor independence in the Nigerian listed firms. The finding agrees with Eiya and Ogbeide (2014); Kantudu and Samaila (2015); Ogbonnaya, Ekwe and Ihendinihu (2016). It however fails to agree with the research findings of Lenox (2005); Qomariah (2013) and Fei (2015).

Audit committee independence is observed to have a positive and significant effect on auditor independence in Nigerian listed firms. The finding is in tandem with studies of Gosh (2009); Chang and Sun (2010); Carcello, et al. (2006) which reported that an effective audit committee independence is favourably associated with audit independence in the post-Sarbenes- Oxley studies. The finding however is inconsistent with Ayoola (2013). Audit tenure exerted a significant impact on auditor independence in the sampled firms. The finding is consistent Salawu (2017); Enofe et al. (2013); Geiger and Raghunandan (2002) and Coyle (2010.

Board gender diversity is positive and non- significant on auditor independence in the listed firms in Nigeria in the reference period. The finding is in line with Thiruvadi (2012); Ittohen et al. (2009); and Bliss, Muniandy and Majid (2007) which reported a positive relationship between presence of women in firms and audit quality. Firm size is negative and significant on auditor independence in the listed firms. The study finding is in tandem with Babatolu, Aigienohuwa and Uniamikogbo (2016).

5. Conclusion and Recommendations

This study examined the factors influencing auditor independence in firms in Nigeria. The study is a departure from previously used measures of auditor independence like audit fee to the use of Beneish M- Score index which has the potency of revealing manipulated accounting numbers and consequently the level of objectivity and independence of the external auditor in the course of audit assignment in firms. This study concludes that audit committee independence, managerial ownership and audit tenure are a key driver of auditor independence among listed firms Nigeria. This study contributes to knowledge in developing countries, being the first to empirically measure auditor independence through the Beneish M- Score index. Following this, the study suggests that listed firms in Nigeria should encourage increased director and managerial ownership in a concentrated manner and independent board members in audit committee as this will contribute to the enhancement of external auditor independence. Future researchers should empirically examine impact of board director religion, proportion of women, board director political connection, and board director attitude to risk, age of an audit firm and spirituality of an auditor independence in Nigeria and other Sub-Saharan African countries.

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