PDF - AN INVESTIGATION ON RELIANCE OF AUDITOR’S INDEPENDENCE ON THE CREDIBILITY OF FINANCIAL REPORTING QUALITY OF CORPORATE ORGANIZATION (CASE STUDY OF FIVE AUDITING FIRM IN ILORIN METROPOLIS). - researchcub.info

CHAPTERONE

INTRODUCTION

1.1.BACKGROUND TOTHE STUDY

The auditing profession performs arole in giving reasonable assurance to the public and users’ of financialstatements, specifically investors and creditors, of the reliability andcredibility of a firms’ financial statements. To fulfill this role, there areseveral principles that auditors should espouse. One of the most importantprinciples is independence. By demonstrating their independence, auditors’opinions on financial statements will be valued by the users. In essence,auditor independence refers to an absence of interest by the auditor in theauditing assignment, thereby avoiding material bias that could affect thereliability and credibility of the financial statements. The auditingprofession promotes the principle of independence to define, defend, and extendthe profession.

Auditor independencealso refersto the independence of the internal auditor or of the external auditor fromparties that may have a financial interest in the business being audited.Independencerequires integrity and objective approach to the auditprocess. The concept requires the auditor to carry out his or her work freelyand in an objective manner.

Financial statements apart fromstating the financial position of an organization, provides other informationsuch as the value added, changes in equity if any and cash flows of theenterprise within a defined period of time to which it relates (Iyoha and Faboyede,2011). This information is useful to a wide range of users making informedeconomic decisions. The quality of financial reporting is indispensable to theneed of users who requires them for investment and other decision makingpurposes. Financial reports can only be regarded as useful if it represents the“economic substance” of an organization in terms of relevance, reliability,comparability and aids interpretation simplicity (Penman, 1984). Ahmed (2003)stated that useful accounting information derived from qualitative financialreports help in efficient allocation of resources by reducing dissemination ofinformation asymmetry and improving pricing of securities. The user offinancial statement which include: shareholders, government, creditors,investors, etc. All rely on the audited financial statement in other to makeinformed decision. Therefore the credibility and reliability of this statementis necessary.

The basic purpose of financialstatements in the view of Meigs and Meigs (1981) is to assist decision makersin evaluating the financial strength, profitability and the future prospects ofa business entity. The basic objective for preparing financial statement is toprovide information useful for making economic decisions. The objective of anaudit of financial statements is to enable the auditor express an opinionwhether the financial statements are prepared in all material respects and alsoin accordance with auditing standard.

In recent times, auditors have beenput under pressure to ensure that their reports constitute assurance toinvestors that their funds are put into good use and properly accountedfor. In Nigeria, every incorporatedcompany is required to appoint an external auditor, who is required to renderan independent opinion on the financial statements; whether or not they show atrue and fair view. The Companies and Allied Matters Act (1990) states thatevery auditor of a company shall have a right of access, at all times, to thebooks, accounts and vouchers of the company and to such information andexplanations as may be necessary in the course of an audit. The auditor shall make a report to themembers of the company on the accounts examined by them. The auditor in performing his duties isexpected to exercise all care, diligence and skills as is reasonably necessaryin each particular circumstance.

Furthermore, there has been muchdiscussion about the independence of Auditors; the leadership of the auditingstandards board, the public oversight board, the independence standards board,and most recently the proposed independence rules promulgated by the Securitiesand Exchange Commission (SEC) has all attempted to clarify and strengthenauditor independence. Also in themedieval era, financial reporting was not necessary and hence financialstatements were not prepared neither used to make decisions; but with therecent development every firm is expected to prepare and report their financialstatement in order to know the financial position of the organisation so that stakeholderscan make decisions.

Audit report is the medium throughwhich the auditor expresses his opinion on the financial statement examined byhim. Due to familiarity, threat ofreplacement of an auditor, provision of book-keeping services by the auditorand many other factors, the auditor may want to issue an unqualified auditreport even when the situation on ground proved otherwise. This situation raises doubt about theindependence of an auditor. Independence is the cornerstone of accountability. The challenge is that corporate managementhires, fires, and pays both their internal and external auditors. Auditors, therefore, develop goodrelationships with management to keep the job of the client. They may not, therefore, be independent ofthe corporate management.

Most studies on Auditor independencehave concentrated on it as a financial reporting issue. But financial reportingis one aspect of the total impact of auditor independence. Much moresignificant is the impact of a set of standards on a company's organisation,philosophy, business structure compliance to the standards, performancemanagement, and internal control and so on.

1.2. STATEMENT OFPROBLEM

In Nigeria, there have been a numberof audit failures, some leading to the restatement of figures in the financialstatements. For example, Lever Brothers,African Petroleum and Cadbury, just to mention a few important ones. Although,it has not been proved by any detailed investigation that these audit failureswere due to impairment of auditor's independence it could reasonably besuspected to be a contributing factor (Adelaja, 2009).

Financial reports as stated in Igben(1999) are meant to be a formal record of business activities and these reportsare meant to provide an overview of the financial position and profitability inboth short and long term of companies to the users of these financialstatements such as shareholders, managers, employees, tax analyst, banks, etc.But in recent times, the financial manipulations, weak internal controlsystems, ignorance on the part of the board of directors and audit committee,manipulation on the part of the reporting auditor and other fraudulentactivities that occur within companies, creating a negative goodwill to thegeneral public. A typical example of a financial statement malfunction is thepopular case of Enron.

Secondly, concerns have been expressedabout the conflict of interest between the statutory role of the auditor andthe other services it may undertake for a client (UK House of Common TreasuryCommittee, 2008). Also, a number ofworrisome audit failures have been recorded across the world: Enron, in the US,Northern Rock in the United Kingdom, Metagelshaft in Germany, Parmalat inItaly; Lever Brothers and Cadbury in Nigeria.Audit firm tenure has also been linked with fraudulent financialreporting. If empirical studies are notcarried out with respect to specific environmental factors and necessarypolicies are not implemented to address shortcomings, the problem of auditorindependence may be exacerbated with likely grave consequences for the nascentNigerian Capital Market.

Finally, it is widely accepted thatindependence is the most priceless asset in the auditing profession and thebasic principle that underpins the reputation of the auditing profession in thepublic eye. By conducting an auditing work independently, auditors protect thepublic's confidence in such services. Despite this, several firms' scandals,directly or indirectly involving auditors, have damaged public confidence inauditor independence. These scandals have taken place not just in one countrybut across the world, these scandals have caused the public suffering hugelosses and have also damaged the reputation of the auditors and the auditingprofession. Although these scandals cannot solely be attributed to the failuresof the auditors, the public perceived that a large part of the responsibilitylay with them. This is because the public expects the auditing profession toperform not just as watchdogs that give them reasonable assurance but also asbloodhounds that track out everything even when there is nothing to provokeauditors' suspicion. Moreover, it is also widely believed that these scandalstook place because of the auditors' lack of independence, as a result ofaccommodating their clients' interests during audits.

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