

### **ABSTRACT**

There has been celebrated cases of corporate frauds and financial misappropriation in Nigeria's big corporations. The series of frauds have left a sense of doubt about the "unbiasedness" of external auditors to render an attest function on the credibility of published financial statements. In this light, this research sought to empirically investigate the Independence of auditors and reliability of financial reports in banking industry. The research adopts a survey and a descriptive research design with a well-structured questionnaire. Data were basically sourced through primary means. The population of the study comprised staff of the twenty four (24) commercial banks in Nigeria. Five banks were selected from the twenty four and One hundred (100) respondents were sampled, twenty from each bank. Four hypothesis were formulated and tested with the use of Chi-square analysis. The analysis resulted into rejecting the four null hypotheses and concluding that; there is significant relationship between audit tenure and reliability of auditors' financial reports; audit firm Competition for service affect reliability of data; auditor-client-relationship affect the reliability of financial report and that there is relationship between audit fee and reliability of auditors' financial report. Among other recommendations, it was recommended that standards of independence for auditors should be designed to promote an environment in which the auditor is free of any influence, interest or relationship that might impair professional judgment or objectivity.

## **CHAPTER ONE INTRODUCTION**

### **1.1 Background to the Study**

Auditor's independence is seen as the backbone of the auditor's profession. It is an important part of the statutory financial reporting process and a necessary condition for adding value to all audited financial report.

Izedonmi (2000) opines that independence is of the mind, characterized by objectivity and integrity on the part of the auditor. Auditor's independence is an important ingredient in audit practice. De Angelo (1981) and Simunic (1984) posit that there is an understanding that auditors face substantial economic cost when there is an occurrence of audit failure but in contrast Becker, DeFond, Jiambalio and Subramayan (1998). DeFond, Raghuraman and Subramanyam, (2002) say that independence could be influenced because auditors are reluctant to bring up issues pertaining to the preparations of the financial statement at the risk of losing lucrative fees from its clients. Becker et al (1998) and DeFond et al (2002) also say that independence could be influenced because auditors are reluctant to bring up issues pertaining to the preparations of the financial statement at the risk of losing lucrative fees from its clients, thereby making the subject theoretically ambiguous.

The concept of auditor independence changed during the late 19<sup>th</sup> and early 20<sup>th</sup> centuries. Because there was a large shift from capital coming from some sources to capital deriving primarily from domestic sources articulated change that large corporations were based on the separation of ownership from management. This emphasized the growing importance and role of accounting and auditing (DeAngelo 1981). The auditors' primary duty was to serve the needs of proprietary interest, which comprises of shareholders and general public. The

creation of SEC laid emphasis on standards for financial reporting and auditing. The concept of auditor independence shifted in favor of objectivity and neutrality in reporting (Carcello, 2004).

In order for the users of financial statements to gain assurance that the data are being reported, properly measured and fairly presented, independent certified auditors audit financial statements and express an opinion on the fairness of these statements. The value of auditing services depends upon the fundamental assumption that the certified auditors are not influenced by their client-firms or by other financial bodies (governmental or non) (Reynolds & Francis, 2001).

The term audit independence refers to the ability of the certified auditor to act with integrity and impartiality during his/her auditing practice (Dye, 1993). The audit of accounts in the corporate sector by an independent auditor is obligatory by statute, which defines his duties, rights and powers. It is essential because of the separation of ownership from the management in the corporate sector as the former needs someone who can keep a professional watch on the latter and to whom they can trust for the reliability of accounts as the preparation of financial statement is the prerogative of the management. The auditor has not much to suggest on the form and adequacy of financial statement and independent auditor is responsible for his report.

Independence is fundamental to the reliability of auditors' reports. Those reports would not be credible, and investors and creditors would have little confidence in them, if auditors were not independent in both fact and appearance, which is expressed by Council of the American Institute of Certified Public Accountants (AICPA) in a statement adopted in 1947. Auditor independence is considered the hallmark of auditing profession. Independence is viewed as the most essential factor in business sector in protecting the interest of several parties.

The issue of Auditor's Independence as an essential platform for quality audit is not debatable. Auditor's Independence is commonly referred to as the cornerstone of the auditing profession since it is the foundation of the public's trust in the accounting profession. More so in this present era of the adoption of new globally accepted rules on financial reporting, the International Financial Reporting Standards (IFRS) and our nation's yearn for direct foreign investment for national development.

Independence, both historically and philosophically, is the foundation of the public accounting profession and upon its maintenance depend the profession's strength and its stature (Carey, 1970).

## **1.2 Statement of the Problem**

The recent corporate accounting scandals have cast doubt on the quality of reported earnings and the ability of audit process to effectively constrain earnings management of companies across the world and Nigeria in particular (Badawi, 2008; Enofe, 2010). Differences in quality of the audit process and auditors reports results in variations in the credibility of auditors and the reliability of the earnings reports of companies. These recent corporate financial failures pose a great challenge to the authenticity, integrity, effectiveness and significance of the audit function. Badawi (2008) reports a list of companies involved in cases of accounting

scandals related to poor audit quality and earnings manipulations in the past decade. In Nigeria, corporate scandals include the cases of Savannah Bank and African International Bank (Odia, 2007); Wema Bank, Nampak, Finbank and Spring Bank (Adeyemi & Fagbemi, 2010); and more recently Intercontinental Bank Plc., Bank PHB; Oceanic Bank Plc. and AfriBank Plc.

Apart from some of the international instances mentioned above, we are also very familiar with some national cases. Aruwa & Atabs (2011) provided instances of creative accounting and fraudulent financial reporting in Nigeria to include Alpha Merchant Bank Plc-accounting problem and market manipulation, Lever Brothers Plc-exaggerated profit through the use of questionable accounting methods and AP Petroleum Plc-false financial reporting. The Cadbury Nigeria Plc misstatement case, which overstated its earnings in its books of account and sanctioned by the Security and Exchange Commission, is well known.

In the Nigerian banking sector, according to the Guardian Newspaper of 21 August 2009, the audit conducted by the Central Bank of Nigeria (CBN) into the activities of the some registered banks in 2009 revealed that they were experiencing huge financial difficulties in their operations. Consequently in August 2009, CBN injected N420 Billion (\$2.8 Billion) into the first five banks (Afribank, FinBank, Intercontinental Bank, Oceanic Bank and Union Bank) which failed the CBN Audit. Two months later, an additional N200 billion was injected to stimulate the liquidity of four other banks (Bank PHB, Equatorial Trust Bank, Spring Bank and Wema Bank). This injection was done to stabilize the banks and ensure they remained going concerns after their former MDs were sacked for reckless lending and lax corporate governance (Nigeria Tribune 17 August 2009 and This Day 12 December, 2009).

Recently also, the Guardian newspaper of 17 October 2011, carried a report that 374 government agencies are yet to clear since 1999 to date the backlog of unaudited accounts and submit to the Auditor-General of the Federation as required by law. The Public Accounts Committee (PAC) of the National Assembly and the Auditor-General are yet to agree on the reasons for such serious lapses by the managers of public funds.

Professional Accountants and Auditors in particular, here are part of our worries. We must be motivated to proffer solutions to this great challenge. In spite of the enabling IT audit tools and the various professional standards issued for guidance and efficient audit work, there are still reported cases of lapses and scandals. The question is why have there been failed banks and companies?

Because auditor independence in fact is a mental state, investors and other users of financial statements cannot accurately assess actual auditor's objectivity; they can only evaluate an auditor's appearance of objectivity. Thus, even when an auditor acts independently in fact and issues an unbiased audit opinion, investor confidence is eroded if investors and other users of the financial statement information do not perceive that the auditor was independent in appearance. Many difficulties as earlier said lie in determining whether an auditor is truly independent, since it is impossible to observe and measure a person's mental attitude and personal integrity.

Based on the above problems, the followings are identified to affect the reliability of financial report of auditors and their dependency;

- i. Length of consistent use of an audit firm. The longer the length of service provided by an audit firm, the more the familiarity with the directors and the higher the chance of compromise.
- ii. Audit firms compete to get services from clients. Auditors could secretly bargain with some member of the executive to secure service from the firm
- iii. Auditor – client relationship could affect the reliability of financial report. If auditor has any form of relationship with client it could affect the report.
- iv. Charges / audit fee of the firm can determine the reliability of financial report. i.e KPMG financial report should be reliable than a street auditor.

### **1.3 Objectives of the Study**

The primary objective of this research is to elucidate on the independence of auditors and reliability of financial reports in the banking industry. Other specific objectives include:

- i. Examining the effect of audit tenure on reliability of financial reports
- ii. To examine the effect of competition of service by auditors on the reliability of financial report.
- iii. To examine the effect of auditor-client-relationship on reliability of financial report.
- iv. Evaluating the relationship between audit fee and reliability of financial reports.

### **1.4 Research Questions**

Supporting the research objectives set out above, the following questions were advanced and answered:

- i. To what extent does audit fee affect the reliability of financial report?
- ii. How does audit tenure affect the reliability of financial report?
- iii. To what extent does audit firm compete for service from clients?
- iv. How does auditor-client-relationship affect reliability of financial report?

### **1.5 Statement of Research Hypotheses**

The following research hypotheses flow from the research questions that were raised;

#### **Hypothesis One**

$H_0$ : There is no significant relationship between audit tenure and reliability of auditors' financial reports

$H_1$ : There is significant relationship between audit tenure and reliability of auditors' financial reports

#### **Hypothesis Two**

$H_0$ : Audit firm competition for service does not affect reliability of data

$H_1$ : Audit firm Competition for service affects reliability of data

#### **Hypothesis Three**

$H_0$ : Auditor-client-relationship does not affect the reliability of financial report

$H_1$ : Auditor-client-relationship affects the reliability of financial report

#### **Hypothesis Four**

$H_0$ : There is no relationship between audit fee and reliability of auditor's financial report.

$H_1$ : There is relationship between audit fee and reliability of auditors' financial report.

## **INDEPENDENCE OF AUDITORS AND RELIABILITY OF FINANCIAL REPORTS IN BANKING INDUSTRY**

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