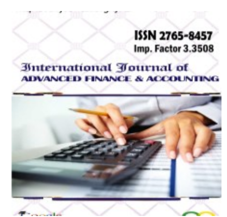
International Journal of Advanced Finance and Accounting | *ISSN 2765-8457*
Published by AIR JOURNALS | *https://airjournal.org/ijafa*
12011 WestBrae Pkwy, Houston, TX 77031, United States
airjournals@gmail.com; enquiry@airjournal.org



RESEARCH ARTICLE

The Impact of Auditors Independence on the Credibility of Financial Statement in Nigeria: An Empirical Analysis

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Accepted: March 24th, 2022	Published: March 31st, 2022

Citations - APA

Chidiebere, N., Ukwueze, N. T. and Eke, C. C. (2022). The Impact of Auditors Independence on the Credibility of Financial Statement in Nigeria: An Empirical Analysis. *International Journal of Advanced Finance and Accounting, 3(2), 14-25.*

ABSTR

This study focused on audit independence and bank financial report credibility. An ex post facto design was used to survey four (4) banks listed on the Nigerian Stock Exchange and functioning in the African region. The data from 2014 to 2018 was examined using multivariable linear regression. According to the data, audit independence had a considerable influence on the value relevance of the banks' financial reports. As a result, the audit costs had little effect on the company's stated earnings per share (a proxy for reliance on financial reports by investors). Further study demonstrates that audit independence has little impact on the timeliness of financial reporting. Banks and other organizations should engage an independent audit company to raise the level of confidence in reported financial statements and so produce a high level of dependability in financial reports. To guarantee the timely creation of financial reports, managers are also obligated to collaborate with auditors impartially.

Keywords: *Audit Independence, Credibility, Financial Statement, Nigeria*

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1. Introduction

Auditing is the process of gathering and analyzing evidence to evaluate the degree to which the provided data corresponds to predetermined criteria (Arens, Alvin, Shailer, and Fielder, 2011). According to Messier (2008), auditing is a systematic process of objectively obtaining and evaluating evidence regarding assertions about economic actions and events to determine the degree of correspondence between assertion and established criteria and communicate the results to interested users. Statutes defining the responsibilities, rights, and powers require independent audits of corporate financial records. This is critical in the business sector due to the separation of ownership and management. Since management has the authority to prepare the financial statements, the owner requires someone who can maintain a professional eye on things and whom they can put their faith in when it comes to the accuracy of the numbers.

As a means of ensuring the accuracy and fairness of the financial accounts, independent certified auditors audit the financial statements and provide an opinion. As a result, it is assumed that the auditor is not affected by their clients or other entities when they provide financial reports. A lack of credibility in financial reports will cause investors and creditors to lose faith in them. Both in reality and appearance, auditors must be free of bias. The independence of the auditor is seen as a pillar of the auditing profession. An essential aspect of the financial reporting process, and a need for all audited financial reports, is an essential component. The importance of audit independence cannot be overstated. According to Izedonmi (2000), the auditor's Objectivity and Integrity are essential to the auditor's independence, which he defines as a mental quality.

The need for auditor independence as a foundation for excellent audits cannot be debated. Research into auditor independence has grown in popularity over the last decade. Corporate managers, business owners, and investors of all kinds are on edge because of several corporate collapses and scandals that have rocked the world's commercial climate. This isn't unrelated. To ensure that financial reporting is as reliable as possible, it is necessary to identify the factors that influence their credibility in Nigeria. As a result, enterprises in Nigeria have begun to use internationally accepted standards of accounting to help safeguard the independence of auditors and improve the credibility of financial reporting.

Statement of the Problem

An audit must be undertaken in accordance with audit independence to fulfill the reasonable expectations of consumers of audited financial statements (Bahram, 2007). If a financial or non-financial gain is at stake, the audit firm and the auditor should not be compromised. From business bankruptcies and audit failures, notably in Nigeria, there has been a loss of trust in financial reporting and auditing. This has prompted improvements in audit independence and quality control. To help restore public and investor trust in corporate financial reporting, there has been an increase in the number of regulations aimed at the industry.

Objectives of the Study

The main objective of the study is to examine the effect of audit independence on the reliability of a bank's financial report but specifically, the study seeks to

i. Examine the effect of audit independence on the timeliness of listed commercial banks' financial reports in Nigeria
ii. Ascertain the effect of audit independence on the value relevance of listed commercial banks' financial reports in Nigeria

Research Hypotheses

Ho_1: Audit Independence has no significant effect on the value relevance of listed banks' financial reports in Nigeria.

Ho_2: Audit Independence has no significant effect on the Timeliness of listed banks' financial reports in Nigeria.

2. Literature Review

Conceptual Review

Concept of Audit Independence

In Bahram (2007), auditors' independence is defined as the capacity to maintain an objective and unbiased mental attitude during an audit. Rick, Roger, Arnold, and Philip (2004) describe the auditor's independence as the ability to run audit tests, analyze the results, and certify the audit report of a business from an objective perspective. Audit independence needs an attitude of responsibility apart from the interest of the client, as explained by Aren et al. (2011). Professional skepticism must be maintained by the auditor. Independent auditors are those who are not subject to any outside influence throughout the course of doing an audit, analyzing the findings, and attesting to the accuracy of the audit report. According to Arens et al. (2011), auditor independence may be explained in two ways: independently of the mind and independently of outward appearance. The auditor's state of mind is reflected in his or her independence of mind, which allows for an objective audit. Longstanding rules compel members to be self-reliant. While others' conceptions of what true independence should seem like lead to the illusion of independence, the reality is quite different. Most of the audit function's usefulness is lost if consumers assume auditors are client supporters when they are independent.

Types of Independence

There are three main ways an auditor’s independence can manifest itself these are programming independence, investigative independence, and reporting independence

Programming Independence: The auditor's ability to pick the best audit technique is safeguarded by programming independence. There should be no restrictions on how auditors approach a piece of work. The auditor's methodology will likely need to change as a client firm expands and engages in new activities. There are continually new procedures being invented and enhanced in the auditing field that auditors have to consider whether or not they are going to adopt. No one can stop the auditors from implementing their strategy/proposed procedures.

Investigative Independence: It is the investigative independence of auditors that allows them to apply the strategies in whatever way necessary, while programming independence safeguards auditors' freedom to pick relevant techniques. For the most part, auditors need complete and unrestricted access to all corporate records. Any questions about a firm's business or accounting practices should be answered by the company. There can be no limitations placed on the audit evidence collecting procedure by the client firm.

Reporting Independence: Any information that an auditor believes should be made public is protected by the auditor's reporting independence. They will try to keep the auditors from revealing this if the firm directors have been deceiving shareholders by misrepresenting accounting information. In instances like this, auditor independence is most vulnerable.

Real Independence and Perceived Independence

One must distinguish between independence in truth (true self-determination) and independence in appearance (false self-determination) (perceived independence). It is impossible to attain self-sufficiency without both of these approaches working together. Independence of thought, or the ability to think for oneself, can be defined as an auditor's real independence. It's the auditor's mindset and how they respond to a certain scenario that truly determines their independence. An independent auditor can make independent decisions even in the absence of independence or if the director of the firm places him in a precarious position. The impartiality of an auditor must be unquestionable, and this may be ensured by their perceived independence, which is extremely crucial (Lindberg and Beck, 2004).

In addition to acting and seeming independent, the auditor must maintain a professional demeanor. An audit report's credibility might be tarnished if certain evidence suggests that the auditor is not truly independent. Additionally, the impression of being independent minimizes the chances of an auditor acting in a non-independent way, which increases the audit report's trustworthiness.

Concept of Financial Reporting

Early attempts to record information date back to 3500BC when it was deemed vital to keep track of payments paid to the Egyptian pharaoh's military forces. Rather than using money, the method of payment was based on the exchange of goods such as livestock, precious stones, and other valuables. Due to the lack of a functioning monetary system and commerce at this early stage, records of this early civilization were inconsistent in their format. As a result, transactions could be documented in terms of a standardized measure of worth rather than in terms of pounds of silver, cowries, and so on.

Luca Pacioli, the inventor of the double-entry bookkeeping system, drastically altered the course of history. De summa, a treatise on mathematics and bookkeeping, introduced the notion of double-entry bookkeeping, which led to ideas like the trial balance and balance sheet. Expanding commerce paved the way for advancements in financial reporting. A greater emphasis was placed on the stewardship role as the company grew in size and complexity over time. As a consequence of the increasing priority placed on good stewardship and the separation of ownership and management, it was necessary to provide shareholders with comprehensive reports on the company's operations. As a result, accurate accounting and a third-party evaluation of management's accountability to shareholders are essential. It's important to understand the difference between financial reporting and financial reporting. Financial statements such as profit and loss statements (P&Ls), balance sheets (B/Ls), income and expenditure statements (I&Es), and cash flow statements (CFSs) are all included under this umbrella term (Olagunju: 2008).

Reports on a company's assets, liabilities, and ownership equity at any particular point in time are known as the balance sheet.

It is also known as a profit and loss statement (or a "p &l"), which summarizes a period of the company's earnings and costs, as well as its profits. An enterprise's profit and loss statement give information about the company's operations. Included in this are the proceeds from the sale as well as the costs paid throughout the manufacturing process explains how a company's retained earnings have changed throughout the reporting period.

Reports on the company's cash flow operations, such as its operating, investing, and financing activities, are referred to as cash flow statements.

Statements for large firms are frequently complicated and may contain extensive notes to the financial statements and management commentary. The notes often include more information about each item on the balance sheet, income statement, and cash flow statement. An important aspect of the financial statements is the notes thereto.

Purpose of Financial Statements

The purpose of financial statements is to offer a wide variety of people making economic choices with information about a company's financial situation, performance, and changes in financial position. Financial statements must be easy to read, relevant, accurate, and comparative. The reported assets, liabilities, and equity of an organization are closely linked to its financial status. It's no coincidence that the financial health of a company is closely tied to its reported income and expenditures.

Readers who have "a reasonable understanding of business and economic operations and Accounting and are ready to study the information attentively" should be able to grasp financial statements. Financial statements can be used for a variety of objectives, including the following:

Financial statements are necessary for owners and managers to make critical business choices that have an impact on the company's long-term viability. These financial statements are then analyzed to offer management a better knowledge of the numbers. As part of management's annual report to stockholders, these statements are utilized.

In the event of labor unions or individual employees, these reports are also necessary for negotiating remuneration, promotion, and ranking with management.

The financial statements of a company are used by prospective investors to evaluate the viability of investing in it. Professionals (financial analysts) produce financial studies, which investors frequently rely on when making investment decisions. Banking and other lending organizations utilize them when deciding whether or not to give money to corporations to fund expansions and other large-scale expenditures, such as long-term bank loans or debentures.

A company's financial records are used by tax authorities to verify the legitimacy and correctness of the taxes and other duties it has paid and disclosed.

It is necessary for vendors who lend money to examine the business's creditworthiness by looking at financial accounts. Financial statements are also of interest to the media and the general public for a variety of reasons.

Reliability and Credibility of Financial Reports

For any knowledge to be useful, it must be understood. To understand a financial statement, one must have a working grasp of economics and business. As a business owner, you must consider the varying levels of accounting experience of the people who will be reviewing your financial statements.

Information that is relevant for anybody to make a choice should be provided and reported. Furthermore, accounting information must also deal with the items that are important to individuals who utilize financial reports in their decision-making process.

On your financial statement, the numbers and data must be accurate. The accuracy of your financial statement is critical.

Data comparability means that information may be compared with other comparable firms so that decision-makers can determine which of their options or decisions to take. For depreciation and inventory management, GAAP allows for several alternative accounting procedures to be used.

Audit Independence and Reliability of Financial Reports

This report is the principal means of communication between auditors and their clients. To ensure that investors and stakeholders can rely on financial reports, an independent, impartial auditor should conduct an objective review and audit of the financial statements, which is most often the independent external auditors. An audit report's reliability refers to the fact that investors and others with a stake in a company's financial statements and state of affairs regard audit reports and the opinions expressed therein as reliable and reputable. In addition, audit reports disclose whether accounting reports are reasonably devoid of mistakes and bias and if the accountants are justified in making a 'going concern' assumption. The audit report must thus provide investors with sufficient information about the quality and correctness of the accounting reports for them to decide to what degree they should rely on the report when making investment choices, which is what it indicates.

When it comes to serving the audit, Ndubuisi and Ezechukwu (2017) said that audit independence serves the audit by ensuring that the auditor would plan and carry out the audit objectively. As a result, the greater aim of audit independence and its goal must be pursued. In contrast, Mitra, Deis, and Hossain (2009) claim that the immediate goal of an audit is to enhance the accuracy of the information being audited. Improvement in the trustworthiness of corporate disclosure lessens the possibility that investors and creditors may be misled by erroneous or otherwise unreliable details. Investors and creditors utilize information to analyze the economic risk of a possible investment, therefore attention should be made while doing audit assignments since risk information is always present.

Investors and creditors have a higher chance of making wise judgments if they have access to better information about economic risk. In other words, they have a decreased danger of information leakage. Investors and creditors' perceptions of information risk are reflected in the cost of financing for businesses. Reliable corporate disclosure benefits both providers and consumers of capital. For investment and credit decision-making, audit independence is well-understood theoretically and practically according to Knechel, Krishman, Pevzner, Shechik, and Velury (2012). Deterrence, detection, and verification are the three pillars of auditing. Management is inhibited from manipulating

financial figures because they know that auditors will be doing their job. It is possible, however, to detect the great majority of distortions that still occur, and selective testing of undistorted information serves as a reliable test. Auditing, according to Asthana, Khurana, and Raman (2018), increases the trustworthiness of the financial data investors rely on to make decisions. Earnings provided to investors have a greater degree of value relevance when they are based on more dependable information. Also, if the bank's financial success is more closely reflected in the data utilized, profits per share are more likely to reflect corporate earning potential. The more accurate financial reports are, the more likely investors are to put their money into the most productive businesses.

The auditors' independence is frequently referred to as providing credibility to the financial report's timeliness, which is a crucial component of auditing, although management's cooperation is also required (Carmona, Momparler & Lassala, 2015). Confidence in financial reporting is influenced by the quality of the audit and the independence of the auditor (Al Khaddash et al, 2013). In the absence of enhanced dependability, investors will have no foundation for trust in the information provided and earnings will no longer have a direct correlation to a company's earning power and reporting timeframe.

Theoretical Review

A central tenet of this research is the Signaling Hypothesis. When one party (referred to as the agent) can legitimately transfer knowledge to another party (referred to as the recipient), this theory applies (the principal). Based on observations of knowledge gaps between firms and potential workers, Michael Spence established this hypothesis first in 1973 and then expanded its application to other fields. To separate themselves from their competitors in the marketplace, signaling theory suggests that companies that do well tend to make more voluntary disclosures. As a result, we believe that the independence of auditors contributes to the trustworthiness of financial reporting. As Scott (2009) points out, managers may use manipulative accounting to send signals by dressing up their reports in a way that consumers would receive the information they want to hear.

Empirical Review

The impact of audit independence on financial report dependability has been studied in both established and emerging economies in some research. According to Okolie (2014), the independence of auditors has an impact on profit management. A selection of 57 Nigerian publicly traded firms from the years 2006 to 2011. Audit fees have a negative but considerable impact on discretionary accruals, according to the findings of the study. An examination of the effects of audit fees in Nigeria on financial reporting quality by Abdul-Malik et al (2016) confirms this. The annual reports of 89 publicly traded corporations from 2008 to 2013 were used to compile the data. Audit fees have a negative but considerable impact on discretionary accruals, according to the findings of the study. Additional research has explored the link between audit fees and the quality of audits in recent years, including Abdul-Rahman et al (2017).

In Nigeria, audit fees are positively and strongly associated with audit quality, according to the country's findings. An empirical study by Kabiru and Abdullahi (2012) looked at the quality of audited financial statements from Nigerian deposit money banks, using both primary and secondary data, and they selected a sample of five banks from a total of 21, all of which are publicly traded Nigerian companies. The five banks in question were: First Bank, Zenith Bank, Union Bank, United Bank for Africa, and Access Bank. They discovered that the quality of audited financial statements of Nigerian money deposit banks was greatly improved by the independence of an auditor. The quality of the audited financial statements of Nigeria's money deposit institutions is significantly improved when auditing criteria are followed. Misrepresentation in Nigerian banks' audited financial accounts has an impact on the quality of their financial reporting. If the audited financial accounts of Nigerian money deposit institutions were re-audited by other independent auditors, they discovered that the same results and conclusions would be reached.

An investigation by Asthana et al. (2018) focuses on the relationship between fee competition among Big 4 auditors and audit quality in the United States. In the highly concentrated US audit market, fee contests are seen as a crucial method for improving audit quality. There are similar studies that evaluate the influence of trust and community collaboration on audit fees in different nations throughout the world by Knechel et al. (2018). Trust and community

collaboration have been shown to increase the chance that countries will spend money on a strong audit and request more expensive auditing services. They argue that nations with stronger trust and community collaboration pay higher audit costs to seek greater certainty. To put it another way, this shows that nations with a higher level of confidence or public collaboration are willing to pay higher audit fees.

Related party transactions and audit fees in Malaysia are investigated by Al-Dhamariet al., (2018). Audit fees for companies involved in related party transactions, such as the purchase and sale of assets, goods, and services are reported to be expensive by them. It is consistent with the findings of the study by Al-Rassaset al., (2015), who examined the impact of external audit quality and audit committee characteristics in Malaysia. Discretionary accruals have a negative and substantial association with audit fees, the study finds. Higher audit costs may be linked to lesser discretion and better financial reporting in Malaysia, according to this study.

3. Research Methodology

With this research, we're looking especially at Nigeria's listed commercial banks to evaluate how to audit independence affects their financial reporting's overall credibility. From 2013 to 2017, a period of five years, the study used ex post facto research design and Multi-variant ordinary least square (OLS) regression to analyze the annual financial statements of four (4) out of the seventeen (17) listed commercial banks on the Nigerian stock exchange market (First Bank, Guarantee Trust Bank, Access Bank, and United Bank for Africa).

Model Specification

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

$VR_{it} = \alpha + \beta 1\ AI_{it} + U_{it}$ $TM_{it} = \alpha + \beta 1\ AI_{it} + U_{it}$

Where;

α = 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 a proxy for value relevance of firm financial statement)
TM = Timeliness of Financial report (Reported number of days between when the auditor signs the financial report and when it is published) **it= Cross-sectional** ($_i$) at the time ($_t$) **U** = Error term used in the model.
β_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.

4. Data Presentation and Analysis

Data Validity Test

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 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 enabling us to go ahead with the regression analysis.

Table 4.1: Descriptive Statistics of Variables

	N	Minimum	Maximum	Mean		Std. Deviation
	Statistic	Statistic	Statistic	Statistic	Std. Error	Statistic
AI	25	9.40	9.70	9.2594	.09732	.53521
VR	25	.18	7.67	1.7056	.38061	1.80213
TM	25	1.90	2.00	1.8737	.02440	.20910
Valid N (listwise)	25					

Table 4.1 presents the descriptive statistics of all the variables. N represents the number of observations and therefore the number of observations for the study is 25.

Audit Independence (AI) reflects a mean of 9.2594 and a standard deviation of 0.0.53521, it has a minimum value of 9.40 and a maximum value of 9.70. Value Relevance (VR) reflects a mean of 1.7056 and a standard deviation of 1.80213, it has a minimum value of 0.18 and a maximum value of 7.67. Timeliness (TM) of financial reports reflects a mean and deviation of

1.8737 and 0.20910 respectively. It also shows a minimum and maximum value of 1.90 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 work presents the results produced by the model summaries for further analysis.

Table 4.2: Univariate Tests

Dependent Variable	Source	Sum of Squares	df	Mean Square	F	Sig.
VR	Lack of Fit	42.634	18	2.549		. .
	Pure Error	.000	1	.000		
TM	Lack of Fit	.204	18	.013		
	Pure Error	.000	1	.000		

Table 4.3: Tests of Between-Subjects Effects

Source	Dependent Variable	Type III Sum of Squares	Df	Mean Square	F	Sig.
Corrected Model	VR	13.415[a]	1	14.414	6.800	.037
	TM	.024[b]	1	.023	3.014	.183
	VR	10.671	1	11.670	5.613	.066
Intercept	TM	.338	1	.338	29.893	.000
	VR	14.414	1	14.414	5.900	.037
AI	TM	.024	1	.024	2.016	.193
	VR	43.634	19	3.313		
Error	TM	.204	19	.012		
Total	VR	114.222	25			
	TM	80.366	25			
Corrected Total	VR	65.048	23			
	TM	.236	23			

a. R Squared = .245 (Adjusted R Squared = .203)
b. R Squared = .102 (Adjusted R Squared = .052)

Table 4.2, presents the regression result between AI and VR, TM. From the model summary table above, the following information can be distilled.

Ho1: Audit Independence has no significant effect on the value relevance of listed banks' financial reports in Nigeria.

In this case, the R2 was 0.245. An independent or explanatory variable's total variance (VR) can be explained by an independent or explanatory variable (R2), also known as the coefficient of determination (AI). A change in independent variable AI (Audit Independence) accounts for 24.6% of the variation in Value Relevance (Reliability of Financial Reports) of the listed firms, and the remaining 75.4% of that variation is explained by other variables not included in this model, as shown by the R2 value of 0.24.

It is estimated that, with an adjusted R2 of 0.203, this result will differ from the expected value by no more than 0.042 when considering the total population. There is a 4.6% discrepancy between the sample and the population as a whole, according to this study's findings. The F-value of 6.800 is also shown in the table.

Model 1's null hypothesis was mentioned above, and the regression result was carried out according to the decision rule previously indicated. In this study, we reject the null hypothesis and accept the alternative hypothesis, because the AI is smaller than the standard significance threshold of 0.05.

Ho2: Audit Independence has no significant effect on the Timeliness of listed banks' financial reports in Nigeria.

There was an R2 of 0.0102. When the coefficient of determination (R2) is calculated, it reveals how much total variance (TM) can be explained by an independent or explanatory variable (i.e., R2) (AI). Thus, the R2 value of 0.102 indicates that 10.2% 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 89.8% (i.e. 100-R2) could be accounted for by other variables not included in this model.

Adjusted R2 implies that if the complete population is included, this result will depart from it by just 0.051 (i.e. 0.102 – 0.052). This finding reveals a 5.1% difference between the population as a whole and the sample that was used to make it. In addition, the table displays the F of 3.014.

Based on the previously stated choice rule and the regression result obtained using model 2's null hypothesis, it is reasonable to assume that model 2 is a valid alternative to model 1. A significant level of 0.193 (AI) is more than the recognized significance threshold of 0.05, hence the study rejects the null hypothesis.

5. Conclusion

Independent audits have a favorable and significant impact on financial reporting dependability. This suggests that the auditors' independence, as defined in this article by audit fees, has a significant impact on the credibility of financial reporting. Researchers have concluded that auditors' independence cannot be revealed from financial reporting credibility; this is reflected in how audit fees do not appear to have a significant impact on the reported earnings per share, which is a proxy for investor confidence in the financial report. This conclusion is supported by the empirical results. Further research found that audit independence had no influence on the reporting timeliness of the companies' financial statements.

6. Recommendation

Based on the outcomes of this investigation, which included both empirical and literary research, several conclusions have been formed. Here are some suggestions for increasing the auditor's independence, which in turn will increase the credibility of the financial statement. At this point, it is regarded suitable to make the suggestions listed below.

1. It is imperative that companies in Nigeria pay the correct audit fees to employ an audit company free of sway. When investors have a high degree of confidence, they are more likely to trust the financial data they get from companies.
2. To further strengthen and enable quick investment decisions, management should collaborate with auditors impartially to ensure timely publishing of financial reports of the business, since investors consider timely reports to be reliable.
3. Auditor independence should be ensured by prohibiting auditors from advising their audit clients in any other capacity.
4. The independence of auditors can be improved if there is a rotation of auditors.

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