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RESEARCH ARTICLE

Auditors' independence as a Tool for Enhancing the Reliability of Financial Reports

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ABSTRACT

This research examined auditors' independence as a tool for enhancing the reliability of financial reports. A survey research design was adopted, out of the 120 distributed questionnaires, 114 was returned and hence valid. Multiple regression was employed in expressing the relationship between variables, OLS regression method of analysis was also adopted and the SPSS output shows auditors' independence has a significant relevance on the neutrality financial reports, auditors' independence has a significant relevance on the completeness of financial reports, and auditors' independence has a significant relevance on the CRF of financial reports. The study's findings had many implications including regulatory implications. The findings imply regulators and standard-setting bodies may need to focus on strengthening regulations and guidelines to ensure auditors' independence is maintained. This may involve setting up more stringent requirements for auditor independence, including restrictions on non-audit services, rotation of audit partners, and other measures to reduce potential conflicts of interest.

Keywords: *Auditors' Independence; Reliability of Financial Reports; Completeness of Financial Reports*

Introduction

In recent years, especially following the great financial scandals (in which the role of auditors has not always been neutral), there has been an increase in concerns for the study of factors that influence audit quality, one of these factors being the auditor's independence. Auditor independence is a cornerstone of the audit profession, a critical element in the legal process of financial reporting that contributes to increasing the added value of the audited financial statement (Claudia, 2020). The auditor's independence is measured by how honest an auditor is in reporting the material misstatements found in the financial statements by managers. Investor's confidence in the auditor depends on the auditor's credibility on how well the intermediary has been correctly verifying the manager's assertions of financial statements. As a result, auditors have to maintain and appear to maintain their independence at all times. This becomes difficult because managers are responsible for hiring and firing the auditor under their authority. Independence is one of the most important attributes of the accounting profession (Aussin, 2014). For audits, independence is a crucial quality because it affects how investors would perceive the credibility and dependability of the financial statements. Auditor's independence increases '' the effectiveness of the audit by ensuring that the auditor carries out the audit objectively (Chepkorir, 2013). The sovereignty of an external auditor demonstrates objectivity and increases the trust of those who place great reliance on it. The auditing profession places a high value on independence; thus, all business environments must be compliant with the corresponding regulations and standards. The need to safeguard an auditor's independence is, therefore, necessary to gain public trust and confidence. Considering the benefits attached to safeguarding auditor independence, the European Commission has issued standards applied throughout the European Union. The USA enacted the Sarbanes Oxley (SOX) Act of 2002, which describes the independence requirements of US auditors. As a guideline, the EU committee on Auditing spells out some fundamental principles which serve as recommendations called Statutory Audit Independence in the EU: A set of fundamental principles (Samuel, 2019). It is important to protect the auditor's independence as various relevant stakeholders rely on and make economic decisions on the financial statements certified by the statutory auditors.

The auditor must not and should not be subject to the management's controls in the company whose accounts he is examining. Instead, he should have unrestricted access to any records and information required for his audit. However, weak independence of auditors has been experienced in most companies and has led to a reduction in the users' level of reliance on the audited financial statements. According to Herath & Pradie (2018), auditors' independence ensures an unbiased perspective and allows financial statements to be more reliable. Firms face the risk of damaging their reputation once auditors fail to report mistakes in their audits.

Overall, this research will contribute to a better understanding of the role of auditors' independence in enhancing the reliability of financial reports and the importance of maintaining an independent and objective auditing process. The findings of this research will contribute to the existing knowledge on auditors' independence and its role in enhancing the reliability of financial reports. The study will also provide recommendations for auditors, regulators, and companies to improve the independence of auditors and the effectiveness of the audit process. Ultimately, the study aims to promote transparency, accountability, and trust in financial reporting, which is critical for the functioning of capital markets.

Theoretical Framework

The theory on which this research work is based is agency theory. It was propounded by Jensen and Meckling (1976). Agency theory illustrates the conflict between principal and agent; where the principal (owner) lacks reasons to trust his or her agents (directors) because of information irregularities and contradictory motives. Information asymmetry deals with the study of decisions in transactions where one party has more or superior information than the other party or parties. External auditors are used as a third party to try to align the interests of agents with principals and to allow principals to assess and manage the behavior of their agents and strengthen the trust. However, this creates a new concept of the auditors as agents, which leads to threats to objectivity and independence. When an auditor performs an audit for a company, they are acting as agents for the principals and this relationship develops similar threats to trust and confidence as the director-shareholder relationship (Adebayo, 2019).

Empirical Review

Internal auditing has been considered for a long time as an ally of strategic management. It provides decision-makers and managers with valuable information and recommendations that enable them to initiate actions to improve the organization's performance. Below are related literature reviews on the relationship between audit independence and financial report quality.

Aliu (2018) researched Auditor's independence and audit quality. The study examines the effect of auditor's independence on the audit quality of listed oil and gas companies in Nigeria over (10) years (from 2007 to 2016). The study uses secondary data which were sourced from the audited annual financial statements of the sampled companies. The sample size comprises nine (9) out of the fourteen (14) companies listed in the downstream sector of the Nigeria Stock Exchange selected using the purposive sampling technique. The panel data were analyzed using descriptive statistics, correlation matrix, and binary logit regression techniques. The findings show that there is a positive relationship between auditor's independence and audit quality, while the control variable of company size and leverage showed a positive and negative relationship with audit quality respectively.

Herath & Pradier (2018) carried out a literature review on auditor independence. The review examined whether the size of the audit firm, the size of audit fees, the auditor's duration with the client, competition among other firms, and the availability of non-audit services will compromise auditor independence. The study reviews empirical studies to assess what researchers have done about auditor independence-related issues and identify gaps in the literature where further research is needed. The findings of this research were that the top determinants of auditor independence were not clear; however, other researchers ranked them based on importance because of the hypothesis that they chose to test. Independence remains a going concern when discovering how reliable and credible financial statements are to investors.

Yiosese (2020) examined the effect of Auditors' Independence on the financial reporting quality of listed manufacturing firms in Nigeria. This objective was achieved by examining the effect of audit fee, audit firm's size, provision of non-audit services, and audit tenure on the financial reporting quality of the listed manufacturing company in Nigeria. Ex-post facto research design was employed with the population consisting of Forty-Three (43) listed firms on the Nigeria stock exchange, out of which sample size is Thirty-Nine (39) was selected. Descriptive and inferential statistics (random effect regression analysis with Panel least square) were employed in the analysis of the secondary data collected from the annual reports and accounts of the sample companies for the period of six years (2013-2018). The result of the study shows that: audit fee and audit firm size have a significant positive effect related on the quality of financial reporting practice of listed manufacturing companies in Nigeria.

Adesola (2021) Investigated the effect of auditor's independence on the financial reporting quality of Parastatals in Lagos State, Nigeria. A survey was conducted to gather data on auditor's independence and a content analysis procedure was adopted to extract secondary data from the audited financial statement of the parastatals. Data were analyzed using binary logistic regression. The findings show that when an auditor alienates his interest in audit and his ability to issue a qualified audit opinion where necessary, have a statistically significant effect on improving both the fundamental and enhanced qualitative characteristics of financial reporting (FQCand EQC). Hence, the more an auditor allows his interests to becloud his judgment, the lower both the FQC and EQC of financial reporting. The outcome of reliance on the work of the internal auditors and auditor's rotation gave an inconclusive result. The study recommended that parastatals must place a premium on promoting auditors' independence to minimize audit failure and the credibility attached to the financial reports.

Methodology

This paper adopted survey research design using a structured questionnaire, while descriptive and inferential statistics were employed in the analyses of the retrieved questionnaire respondent. 120 structured questionnaires were randomly distributed to these staff of the adopted manufacturing firms in Nigeria, from which 114 responses were obtained from the respondents. The gathered data were analyzed using descriptive and inferential statistics. The questionnaire was distributed to 120 staff out of which the researcher received 114 responses for analysis. This gives a response rate of 95%. For unwavering quality, the Cronbach alpha was utilized to test the dependability of the instrument. Statistical Package for Social Sciences (SPSS 28.0) was used to analyze the data collected.

Model Specification

The model was derived using functional relationship between the dependent variable i.e., auditors' independence, and the independent variable; reliability of financial reports.
Y = f(X)
Y= Dependent Variable (Reliability of Financial Report-ROFR)
X= Independent Variable (Auditors Independence-AI)
The proxy for reliability of financial report is stated below
C = Completeness
N = Neutrality
CRF = Compliance with regulatory framework,
while proxy for auditors' independence is:
NFI = Non-financial interest of auditors (NFI)
AF = Audit fees (AF)
AT= Auditors' tenure (AT)

Models

$$\text{Nuetrality} = \lambda_0 + \lambda_1\,\text{NFI} + \lambda_2\text{AF} + \lambda_3\text{AT} + \mu_i \quad 1$$
$$\text{Completeness} = \lambda_0 + \lambda_1\,\text{NFI} + \lambda_2\text{AF} + \lambda_3\text{AT} + \mu_i \quad 2$$
$$\text{CRF} = \lambda_0 + \lambda_1\,\text{NFI} + \lambda_2\text{AF} + \lambda_3\text{AT} + \mu_i \quad 3$$

Reliability of the Instrument

The reliability of the research instrument used in this research work was determined using Cronbach's Alpha.

Table 1: Reliability Test

Statement of Items	Cronbach's Alpha	N
Auditors' independence and neutrality of financial statements	0.721	7
Auditors' independence and completeness of financial statements	0.792	7
Auditors' Independence and compliance with regulatory framework	0.815	7

Table 1 is the Cronbach's Alpha of the reliability of the instrument used in the study.

Data Testing and Analysis

Hypothesis One

H_0: Auditors' independence has no statistical significance on the neutrality of financial reports.

Table 2: Neutrality of financial reports and auditors' independence

Predictor variables	Coefficients	t-Statistic	Prob
NFI	0.111	1.217	0.090
AF	0.237	2.332	0.014
AT	0.468	2.891	0.002
R^2	**0.543**		
Adj R^2	**0.511**		
F-Stat	**14.95**		
Prob(F-Stat)	**0.001**		

Findings

Table 2's regression result shows an adjusted R-squared of 51.1%, indicating that the combined effect of the predictor variables that comprise the auditor's independence (NFI, AF, and AT) on financial report neutrality is statistically significant. Furthermore, the influence of auditor independence on the neutrality of financial reports is strong, as proved by the adjusted R-squared of 51.1%; however, 49.9% of the variations in the neutrality of financial reports were not accounted for in this study.

Decision

From the regression result, in Table 2, there is empirical evidence that the variables of auditor's independence contribute significantly to improve the neutrality of financial reports. From the study, the AdjR2 = 0.511; F-Stat. = 14.95; P-value = 0.001. Consequently, we do not accept the null hypothesis that says, there is no significant relevance between auditors' independence and neutrality of financial statements but accept the alternative hypothesis that at 5 % level of significance auditors' independence has a significant relevance on the neutrality financial reports.

Hypothesis Two

H_0: Auditors independence has no statistical significance on the completeness of financial report.

Table 3: Completeness of financial reports and auditors' independence

Predictor variables	Coefficients	t-Statistic	Prob
NFI	0.097	1.045	0.234
AF	0.447	2.329	0.018
AT	0.315	2.991	0.004
R^2	**0.243**		
Adj R^2	**0.204**		
F-Stat	**18.38**		
Prob(F-Stat)	**0.000**		

Findings

The regression result from Table 3 indicates adjusted R-squared of 20.4% which shows that the combined effect of the predictor variables that make up the auditor's independence (NFI, AF and AT,) on completeness of financial report is statistically significant. Furthermore, the influence of auditor's independence on the completeness of financial report is low due to the adjusted R-squared which is at 20.4%, this reveals that 79.6% of the variations in the completeness of financial report were not measured in this research work.

Decision

From the regression result, in Table 3, there is empirical evidence that the variables of auditor's independence contribute significantly to improve neutrality of financial reports. From the study, the AdjR2 = 0.204; F-Stat. = 18.38; P-value = 0.000. Consequently, we do not accept the null hypothesis that says, there is no significant relevance between auditors' independence and completeness of financial statements but accept the alternative hypothesis that at 5 % level of significance auditors' independence has a significant relevance on the completeness of financial reports.

Hypothesis Three

H_0: Auditors independence has no statistical significance on the compliance with regulatory framework of financial report.

Table 4: CRF of Financial Reports and Auditors' Independence

Predictor variables	Coefficients	t-Statistic	Prob
NFI	0.410	3.707	0.000
AF	0.261	2.470	0.033
AT	0.368	2.722	0.001
R^2	0.178		
Adj R^2	0.139		
F-Stat	8.342		
Prob(F-Stat)	0.037		

Findings

The regression result from Table 4 indicates adjusted R-squared of 13.9% which shows that the combined influence of the predictor variables that make up the auditor's independence (NFI, AF and AT,) on the compliance of the regulatory framework of financial report is statistically significant. Furthermore, the influence of auditor's independence on the CRF of financial report is low due to the adjusted R-squared which is at 13.9%, this reveals that 86.1% of the variations in the CRF of financial report were not measured in this research work.

Decision

From the regression result, in Table 4, there is empirical evidence that the variables of auditor's independence contribute significantly to improve neutrality of financial reports. From the study, the AdjR2 = 0.139; F-Stat. = 8.342; P-value = 0.037. Consequently, we do not accept the null hypothesis that says, there is no significant relevance between auditors' independence and CRF of financial statements but accept the alternative hypothesis that at 5 % level of significance auditors' independence has a significant relevance on the CRF of financial reports.

Implication of Findings

Here are some possible implications:

i. *Regulatory Impact:* Regulators and standard-setting bodies may need to focus on strengthening regulations and guidelines to ensure auditors' independence is maintained. This may involve setting up more stringent requirements for auditor independence, including restrictions on non-audit services, rotation of audit partners, and other measures to reduce potential conflicts of interest.
ii. *Enhanced Trust:* The finding can help enhance public trust and confidence in the audit process and financial reporting. If auditors are seen as independent and impartial, stakeholders are more likely to trust the information presented in financial reports and also improve compliance with the regulatory framework.
iii. *Audit Quality:* The finding suggests that the quality of audits is closely linked to auditors' independence. Audit firms may need to invest more in ensuring that auditors maintain their independence and objectivity to improve audit quality.
iv. *Improved Financial Reporting:* The finding suggests that the completeness of financial reports is closely linked to auditors' independence. Audit firms may need to invest more in ensuring that auditors maintain their independence and objectivity to improve the completeness of financial reports, which in turn can improve the quality of financial reporting and benefit all stakeholders.
v. *Importance of Independence:* The finding emphasizes the importance of auditors' independence in ensuring that financial reports comply with the regulatory framework. It highlights the need for auditors to maintain a high degree of objectivity and impartiality in their work to ensure that financial reports are in compliance with relevant laws, regulations, and accounting standards.

vi. *Improved Compliance*: The finding suggests that compliance with the regulatory framework is closely linked to auditors' independence. Audit firms may need to invest more in ensuring that auditors maintain their independence and objectivity to improve compliance with the regulatory framework. This can help improve the quality of financial reporting and reduce the risk of noncompliance.

vii. *Professional Development*: The research finding may also have implications for the professional development of auditors. It may be necessary to focus on training and developing skills to help auditors maintain their independence and objectivity, and ensure that they have the necessary knowledge and expertise to identify and report on compliance with the regulatory framework.

Conclusion and Recommendation

This paper examined the importance of auditor independence in enhancing the reliability of financial reports. The study is motivated by the need to ensure that financial reports provide users with accurate and reliable information. The results suggest that auditors' independence is a critical factor in ensuring the reliability of financial reports. The study identifies potential threats to auditor independence, such as the provision of non-audit services, and the consequences of compromised independence on the reliability of financial reports. The paper concludes that auditors must maintain their independence and objectivity to ensure the reliability of financial reports. The study suggests that regulators and standard-setting bodies need to strengthen guidelines and regulations to ensure auditors independence is maintained. This paper contributes to the ongoing debate on the role of auditor independence in ensuring the reliability of financial reports and provides valuable insights for regulators, auditors, and financial statement users.

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