

MANAGEMENT INFLUENCE AND AUDITOR'S INDEPENDENCE IN NIGERIAN BANKS

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Abstract

The study examines the effects of management influence on auditor's independence in Nigerian recapitalized banks: issues, challenges and prospects. The study made use of a survey design and data were collected by the use of questionnaires and analyzed using the ordinary least square (OLS) method. The results therefore revealed that there is a significant influence between management influence and auditor's independence. Conclusively, the role of the auditor has evolved from fraud detection to expressing of opinion on the truth and fairness of financial statements. It has been observed that firms including banks in Nigeria have gone insolvent with clean audit reports; when legislation requires the auditor to qualify his opinion if he is of the view that the enterprises is unlikely to continue as a going concern. It is recommended that external auditing firms should be prohibited from providing certain non-auditing services especially those linking them directly to financial information and design, internal control, tax consultancy etc alongside auditing functions. Finally, the accounting professional bodies should team up and establish a monitoring system or mechanism to lead the crusade on transparency and accountability in reporting.

Keywords: Audit, Insider loan, Marginal loan, Agency relationship, Auditor's independent

INTRODUCTION

As a result of the significant number of financial statement frauds in the late 1990's and early 2000's, auditor independence became a widely debated topic in the popular press and by the Securities and Exchange Commission (SEC, 2000). The Sarbanes-Oxley Act of 2002 (SOX) was the culminating regulatory change brought about as a result of the accounting scandals. Included in SOX are multiple attempts to enhance auditor independence. One specific provision of SOX directed at increasing auditor independence is the enhancement of audit committee's responsibilities to eliminate management influence on the external auditor.¹ Included among the audit committee's new responsibilities is the responsibility for auditor appointment. To date, we are unaware of any large sample, empirical evidence documenting the effectiveness of SOX on auditor appointment decisions.

Section 301 of SOX states "The audit committee of each issuer, in its capacity as a committee of the board of directors, shall be directly responsible for the appointment, compensation, and oversight of the work of any registered public accounting firm employed by that issuer... for the purpose of preparing or issuing an audit report or related work, and each such registered public accounting firm shall report directly to the audit committee."

While recommendations existed for auditor appointment to be a responsibility of the audit committee prior to the Sarbanes-Oxley Act 2002, no statutory requirement existed until the enactment of SOX. Prior research has documented negative consequences on auditor independence resulting from management influence on the external auditor. For example, Carcello and Neal (2000; 2003) find that in the event of adverse auditor negotiations (e.g., determination of whether to issue a going concern opinion), the threat of dismissal by management and audit committee independence affects auditor decisions. As such, by eliminating management threat of dismissal through audit committee responsibility for appointment and termination, overall auditor independence is expected to be enhanced.

To enhance auditor independence, the Sarbanes-Oxley Act 2002 placed responsibility for a firms' relationship with the external audit firm directly on the audit committee. This shift of responsibility represents a regulatory attempt to eliminate management influence on the external auditor by inserting an independent audit committee between management and the external auditor. The Sarbanes-Oxley Act (hereafter SOX) states that the audit committee "...shall be directly responsible for the appointment, compensation, and oversight of the work of any registered public accounting firm ..." (Section 301, SOX). This regulation represents a new statutory requirement for independent audit committees.

However, the effectiveness of the regulation in enhancing auditor independence remains uncertain. To evaluate this new requirement, we examine if management influence impacts

audit firm selection decisions in the post-SOX era and whether management influence impacts auditor independence. In a survey of Big4 partners and managers, Cohen et al. (2010) find external auditors perceive management as 'key drivers in determining auditor appointments and terminations' post-SOX. In a survey of audit committee members, however, Beasley et al. (2009) find audit committee members perceive themselves as fulfilling the responsibilities outlined by SOX, including the appointment and termination of the external auditor. These studies provide conflicting evidence on the effectiveness of regulation requiring audit committee responsibility for audit firm selection. Our study provides the first large-sample empirical evidence evaluating the effectiveness of this provision of the Sarbanes-Oxley Act. To empirically examine the impact of management influence on the audit firm selection decision, we use management affiliations as a proxy for management influence.

Management influence on the audit committee, and consequently the external auditor, can take many forms and is therefore difficult to empirically observe. The identified management influences which constituted key problems to this study are none audit duties, earnings management, marginal loans, insider loan and agency relationship. Managers' prior employment experience on the identified problems with external audit firms provides an empirically observable proxy for management influence. The main objective of the study is to examine the extent of management influence on auditors' independence in Nigerian banks.

Research Hypotheses

1. H₀1: Non audit duties does not significantly influence audit quality.
2. H₀2: Earnings management does not significantly influence audit quality.
3. H₀3: Marginal loan does not significantly influence audit quality.
4. H₀4: Insider loan does not significantly influence audit quality.
5. H₀5: Agency relationship does not significantly influence audit quality.

LITERATURE REVIEW

Theoretical Framework

The theories behind this principle which this research value much are independence, ethical and honesty.

Independence Theory

Auditor independence has been termed the cornerstone of the auditing profession, since it is the foundation for the public's trust in the attest function (Caswell et al, 2001). Independence helps to ensure quality audits and contributes to financial statement users' reliance on the financial

reporting process. McGrath, Siegel, Dunfee, Glazer & Jaenicke (2001) argued that when independent auditors render unbiased audit decisions, the broader goal of auditor independence, namely “to support user reliance on the financial reporting process and to enhance capital market efficiency” is accomplished.

Auditor independence has long been considered in terms of independence “in fact” and independence “in appearance”. An auditor is “in fact” independent if he or she has the ability to make independent audit decisions even if there is a perception of lack of independence or if the auditor is placed in a potentially compromising position (McGrath et al, 2001). However, even when the auditor is “in fact” independent, one or more factors may lead the public to believe the auditor does not appear to be independent. This may in turn cause users of financial statements to believe they cannot rely on financial information (Lowe & Panny, 1995, 1996). Thus the perception of investors and other users of financial information is also an important consideration in auditor independence debate. Because the goal of auditor independence is to support user relevance on the financial reporting process, auditors must be independent both “in fact” and “in appearance”. According to McGrath et al (2001), actual auditor independence is a mental state, and is in essence embedded in an individual auditor’s mind. Accordingly, it is impossible for investors and other users of financial statement to accurately assess actual auditor’s objectivity. Therefore, users of financial statement information can only evaluate an auditor’s appearance of objectivity.

Ethical Theory

According to Belkaoul (2000), ethics means moral philosophy or practical morality; it is the application of moral principles to guide personal conduct and social interactions. Morality attempt to tell us what is good and what is bad, and its sources include religion, laws, culture and tradition etc and it is perceived by different people in different ways based on their believes. Accounting code of ethics, basically defined proper professional conduct in terms of integrity, objectivity and independence – all to protect the public interest.

The underlying reason for a high level of professional conduct by any profession is the need for public confidence in the quality of service by the profession, regardless of the individual providing it. If user of service do not have confidence of physician, judges, engineers or accountants, the ability of those profession to serve clients and public effectively is diminished. For the accountant, it is essential for client and external financial statement users to have confidence in the quality of audits and other services. This is so, as it is not practical for users to evaluate the quality of the performance of most professional services because of their complexity. For instance a patient cannot be expected to know whether an operation was

properly performed. In the same vein a financial statement user cannot be expected to evaluate audits performance. Accounting as a socially constructed discipline has no immutable laws and truths (Solomon, 1991).

If principles and standards are framed in broad terms and subjected to varying interpretations especially between the preparers and users of the financial statements. To unify these differences will amount to endless rules for each specific situation and reduces accounting function to a rule following exercise without professional judgement which is very important in a profession given this situation, it is therefore the auditors professional duty and moral obligation to perform ethically and reflect the true and fair state of affairs in his reportage of the financial statement and uphold the integrity of the profession (Ugbe, 2010). In this way, the amount and level of opinion expressed depends solely on the ethical attitude of the auditor.

Honesty Theory

The need for an auditor to be honest is absolutely necessary. The end result of any audit exercise is the report which the public will rely on, as an unbiased and objective statement of the true state of affairs. If the auditor is not honest and is willing for whatever reason to report less than the whole truth, then his work will be of no value (Okolo, 1984).

Auditors add to the reliability and quality of financial reporting, they provide to directors and management constructive observations arising from the audit, process; and thereby contribute to the effective operation of business capital markets and the public sectors.

History of Management Influence on Auditor's Independence

Auditor's independence has been termed the cornerstone of the auditing profession, since it is the foundation of the public's trust in the attest function. Independence is fundamental to the reliability of auditors report. 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". To be credible, an auditor's opinion must be based on an objective and disinterested assessment of whether the financial statements are presented fairly in conformity with generally acceptable accounting principles. As expressed by council of the America Institute of Certified Public Accountants (AICPA) in a statement adopted in 1947.

"Independence both historically, is the foundation of the public accounting profession and upon its maintenance depends the profession's strength and its stature"

If the auditors opinion must be in fact and in appearance how then does the management influence the duty of the auditor. According to Mr Jim Henry a chartered accountant and a partner of Jim Henry and Co. questioned thus, "what can the auditor do, when

the auditor only audits what the management want him to see and audit". This is to say, that what the management don't want to be audited they may devise a means to ensure that those aspect of the transaction of the firms are not allowed access to auditor. According to Ugbe, (2010), "it is relatively easy for an auditor to detect error, but earnings management can involve sophisticated fraud that is covert. He went on to say that, the requirement for management to assert that the accounts have been prepared properly offers no protection where those managers have already entered into conscious deceit and fraud. He went on to caution "Auditors need to distinguish fraud from error by identifying the presence of intentions. Great advice in the prevailing situation, what is the meaning of intention". Maximizing shareholders wealth which is positive or to "cook the books" (Sanusi Lamido Sanusi 2009). Cooking the books is always intentional and in some cases the auditors are in the "know" of what is wrong with the financial statement of the firm. This is so since they audit the books of the company year in year out. Anderson, Enron former auditors could not deny the fact that it did not know about the covert and overt intentions of the company when it was coasting to failure and the company was still issuing unqualified reports on the financial state of the company till the day it collapsed finally and the bubble burst. Bymes et al (2002) has an answer for this. According to them, "the accounting firm Author Anderson, Enron's former auditors for, among other things lacking independence, since the accounting firms earned more revenue from non-audit services than from audit services. If this is the case, is there conflict of interest? Bazerman, et al contented that "the provision of most non-audit services threatens auditor's independence, since economic bond, which the auditor does not want to lose, develops between the client and the accounting firm". It is important to mention that management can use the non audit services rendered by the company's auditor to make him look the other way while illegalities are committed in the financial statement being audited by him. That is to say, the financial statement will look good an appearance and not in fact.

In November of 2000, the United States securities and exchange commission (SEC) adopted a new rule that prohibit accounting firms from providing certain non-audit "consulting" services to their audit clients. The rule also required public companies to disclose in their proxy statements the fees paid to their independent auditors for audit and non audit services. In adopting the rule, the security and exchange commission (SEC) argued that a basic conflict of interest exists in providing both auditing and consulting services to a client. That conflict the commission claimed undermined the integrity of audits. Over the year's management have refused to deal with individual accountant or auditors to audit their financial statement but instead opt to the use of accounting firms to audit their accounts. Where the auditor is one person, the issue of auditor's liability is uppermost in his mind and will go a great length to

ensure that his report really reflects the position of the firm in fact and appearance. In essence the audit report should be signed by an accountant who is an individual who will also have some level of fear to disclose any perceived weakness in the financial statement so audited in order to escape liability. But when it involves a firm which is made of partners, nobody is held liable but the firm which is only an entity like in the case of Enron. Enron as a firm only suffered collapse but all the auditors in Author Anderson and Co. (auditing firm) went free. According to Hon. Justice Abang of the Federal High Court Lagos on a case between Mazi Okechukwu Unegbu and KPMG professional services and Guinness Nigeria plc on who should sign an audit report stated thus “The fact that under section 358 (4) of CAMA a firm is qualified for appointment as auditors if the partner are qualified Accountants cannot be interpreted to mean that the name and signature of a person on a financial statement of a company that was enrolled to practice as an accountant under section 8(1-3) of ICAN Act should be dispensed with (law report as reported in the this day newspapers of 12th February 2011).

This is to say that the audited financial statement should be signed by a chartered accountant and partner of the accounting firm and not on behalf of the firm itself, although as stated by Section 358 (1) and (4) and paragraph 16.2 of the Nigerian standard on auditing issued by the institute of chartered accountants of Nigeria in November 2007, that “an accounting firm is qualified to be appointed as, auditor could legally sign such reports provided the official seal of the chartered accountant signing the report was used”. The court held that “it is only an accountant which includes an auditor as defined by law and not an audit firm that can sign documents certifying the action taken is in compliance with the various provisions of the law and in particular the financial statement and auditor’s report”.

Management Influence on Auditors Independence, Meaning and Concept

According to Ekezie (2008), the fundamental concept of professional independence is an attitude of the mind based on integrity and an objective approach to work. He maintains that an auditor must at all times; perform his duty objectively by any consideration which might appear to be in conflict with this requirement. Also Appah (2008) noted that independence in auditing means having a position to take an unbiased view point in the performance of audit test, analysis of results and attestation in the audit report. It is where the auditor should not be under the influence of client or management at any given time. On the same note, the independence standard board cited in Salehi (2009) defines independence as freedom from pressures and other factors that impair or are perceived to impair, an auditors willingness to exercise objectivity and integrity, when performing an audit. It is the absence of certain activities and relationships that may be perceived to impair an auditor’s willingness to exercise objectivity and

integrity when performing an audit. Ekezie (2008) argued that professional independence may either be corporate or individual independence. Corporate independence means, independence of professional accountancy body as a whole where as individual independence is that of a member of an accountancy body. Independence can also be viewed as independence “in fact and in appearance”.

Independence may be in the state of mind. This requires the auditor to be free from bias, personal interest, prior commitment to an interest or susceptible to undue influence. This means that an average auditor possessing the requisite state of mind will act in the correct way that will not affect the professional duty of due care and skill; the international federation of accountants of London (IFA, 2003) code states that the state of mind permits the provision of an opinion without being affected by influence that impairs professional judgment, allowing an individual to act with integrity and exercise objectivity and professional skepticism. Salehi (2009) notes that auditors should not be independent in fact but more fundamentally, they should be seen to be independent in evaluating the financial statement.

Therefore, auditors are expected to be able to independently decide on reporting strategies with any undue influence from client (Culliman 2004). Independence in fact means the objective relationship as perceived by the client and third parties. Independence in fact enhances the reliability of financial statements, whereas appearance promote public confidence as to enable users rely on financial statements. (Church and Zhang, 2002). According to Ezeikpe (2004), Appah (2008) and Salehi (2009) viewed from three dimensions. These include:

1. Programme Independence

Auditors must remain free from interference or influence from managers and clients, who may intend to restrict, specify or modify the procedure the auditors want to perform, including attempt to assign personnel or otherwise control the audit.

2. Reporting Independence

The auditors must at all times not let any feelings of loyalty to the client interfere with that obligation to disclose fully and fairly. Neither should management be allowed to exert pressure or over-rule auditors judgment on the content of an audit. On the same view Salehi (2009) stated that the auditor should exercise

Freedom from feeling of obligation to modify the impact or significance of reported facts; freedom from pressure to exclude significant matters from internal audit reports; avoidance of intentional or unintentional use of ambiguous language in the statement of facts, opinion and

recommendations and in their interpretation and freedom from any attempt to over-rule the auditors judgment as to either facts or opinion in the internal audit report.

3. Investigative independence

The auditor should have free access to all books, records, correspondences and other essential materials for their job. It also involves active co-operation from management during audit examination, freedom from any management attempt to specify activities to examine or to establish the acceptability of evidential matter and freedom from personal interests by the auditor leading to the exclusion from or limitations on the audit examination Salehi (2009).

Nature of Management Influence on Auditor Independence

There are several factors and manners that management employs to affect or impede the independence of an auditor. These factors include contingent fee arrangements, gift, opinion shopping, reporting relationship etc. According to Salehi (2009) there are factors that affect the independence of auditor that have been studied. These factors include:

- The effects of gift
- The purchase of discount arrangement
- The audit firm size
- The provision of management advisory services by the audit firm
- The client financial condition
- The nature of conflict issue
- The audit firms tenure
- The degree of completion in the audit services market.
- The size of the audit fee or relative client size
- The audit committee
- Practicing non audit services by auditors

Auditor's independence from management is compromised by any relationship that builds a common identity between the two. This is what is called "coalition of the willing". Psychologically research on the "minimal group paradigm; has demonstrated how easy it is to establish a group identity that leads people to favour fellow in-group members (Tajfel & Turner, 1986). Thompson (1995) has shown that even the most superficial affiliation with a partisan leads people to interpret ambiguous information in ways that are consistent with the partisans interests. Indeed, several studies have found that auditor independence and the quality of auditing decisions deteriorate over time as the auditor-client relationship lengthens (Beck et al 1988).

In addition, there can hardly be a more effective means of establishing a common identity between auditor and client than relating personnel between the two. This was the case in Anderson's relationship with Enron, as it is with other accounting firms and their clients. Obviously, independence is compromised when an auditor hopes to develop job opportunities with the audited firm. The financial restriction on personnel relation established by the relevant act and accounting bodies around the world are clearly insufficient, given the high frequency with which auditors at all levels take jobs with audit clients.

Techniques for Evaluation of Auditors Independence

The duty of an auditor is to express an opinion as to the financial statement as presented. For an auditor to be, there has to be an engagement letter which spells out the conditions of the engagement. In evaluating the auditor's independence, the first question that should come to mine is, who hires and fires the auditor? Clients, who have the freedom to choose their auditors, have many reasons to select an auditing firm based on the likelihood that the auditor will deliver affirmative audit opinion. The fact that the probability of a client switching auditors increased following a critical audit report is likely to reduce the auditors' desire to file such a report. According to Beeler and Hunton (2003) one practice that auditors might use to signal their willingness to accommodate the client wishes is known as "low-balling" offering a discounted price for audit services in order to build a relationship that could become profitable later, either by increasing audit fees or by cross-selling services. According to Beeler and Hunton (2003) there is some evidence that low-balling increases auditor's willingness to acquiesce to the clients desires.

Another technique for evaluating auditor's independence is the fear of being fired. Some researchers have pointed out that the size of the audit firms would affect the degree of which they fear being fired. Good news for the large audit firms, but what happens to the small ones. According to De Angelo (1981) and Simunic (1984) they argued that larger audit firms ought to be more resistant to client pressure to manipulate reported earnings. For the small audit firms Eichenseher (1984) have suggested that they should have "brand names". According to Eichenseher brand name auditors are at least perceived to be independent. However research in this area has been inconclusive. Pany et al (1985) have failed to find out an effect of audit firm size.

Auditor's independence from their clients is compromised by any relationship that builds a common identity between the two. This may take the form of auditors taking jobs with clients. Thompson (1995) has shown that even the most superficial affiliation with a partisan leads people to interpret ambiguous information in ways that are consistent with the partisan's

interest. Indeed, several studies have found that auditor independence and the quality of auditing decisions deteriorate over time as the auditor client relationship lengthens Beck, Frecka & Solomon (1988). The worst form of this identity may be that of personnel relation between the two. This was the case in Anderson's relationship with Enron, as with other accounting firms and their clients.

Another area that auditor's independence can be evaluated is in the area of non-audit services. According to Salehi (2009) non-audit services may be any services other than audit provided by an auditor to an audit client. According to Salehi, public accounting firms expanded the scope of their services to include corporate and individual tax planning, internal audit outsourcing and consulting related to mergers and acquisition and information system. It is argued by many researchers, that it is more economic for auditors to provide other additional services to their clients, since the auditors already has, a good knowledge of their clients business Islam et al (2006). According to Beattie and Fearnley (2003), it is evident that in some cases fees received from non audit services far exceed that received from audit services; where this is the situation Appa (2011) has put forward a suggestion. According to him, when audit and non audit services are provided to the same client, the provider needs to be careful not to jeopardize their independence. Because where the line cannot be drawn, there may come a point where the independence of an auditor may be threatened.

Components of Auditor Independence

Independence is the ultimate principle of auditing and ethics. This is to say that for the auditor to be said to be independent. He has to exhibit some principles consisting of rationality, fairness, impartiality, efficiency, refraining from willing harm to a human being and role responsibility Elegido (1996). The components of auditors independence borders on ethics. The syllabus of the institute of chartered accountants of Nigeria (ICAN) has listed four components of auditor's independence. These are integrity, obligation, independence and public expectation. Independence is absolutely necessary if the report issued by the auditor is to even worth the pieces of paper in which it is written on. According to Willington and Pany (2004), the auditor who has lost his independence, has lost his integrity and the entire accountancy profession may be led to a negative view from the public.

To be independent the auditor must be intellectually honest, to be recognized as independent, he or she must be free from any obligation to or unfair personal interest in the clients business, its management or owners (Ofiafo, 2009). An opinion by an auditor as to the fairness of the statement of accounts in fact and in appearance is of no value unless the auditor is truly independent.

Consequently, the auditing standard states “in all matters relating to the assignment of independence, mental attitude is to be maintained by the auditor. This perhaps, is the most essential factor in the existence of accounting profession. The auditor must not be perceived as being under the influence or control, or having any vested interest in the results reported in the financial statements. The guidelines helpful in achieving these goals are found in the code sections on the integrity and objectivity for Certified Public Accountants (CPAs). This notion is termed independence. Being independent in fact simply means that one should not only unbiased, impartial and objective but also is perceived to be that way by others. Independence is so fundamental to auditors that anything that will act in any way to impair his independence must be done away with. For instance, the association of international certified public accountants (AICPAs) rules pertaining to independence for CPA states, “A CPA lacks independence and thus may not audit a company if he or she or the spouse or dependent” owns stock in that company and/or has certain other financial or employment relationships with the client”.

Responsibility of Auditors' Independence

Willington and Pany (2004) referred independence to mean the ability of a certified accountant to maintain an objective and impartial attitude throughout the engagement. The implication here is that, independence increases the effectiveness of an audit by providing assurance that the auditor will plan and execute his work with objectivity, integrity, unbiasedness and what I may call “level headedness”. This is because, high quality audits enhance the reliability of the financial reporting process and facilitate optimal allocation of capital by invertors and other users of the financial statement. The auditors report is prepared for the directors who might have formed part of financial accounts preparation process. And the directors are to present the report to the owners (investors) of the company. The investor seeing this report will have full confidence on it and will in turn swallow it “hook, line and sinker”. Where this report was biased, an unmitigated damage has been done to the general public. This is what sparked an uproar in the American congress on July 5, 1982, when a peat Marwick, Mitchel and company endured considerable criticism for its role in the penn square collapse. In a congressional testimony in the United States congress, Peat Marwick partner explained that “his firm’s audit report was intended only for the banks’ directors, and not for the general public”, Ferris (1993). Terrible lies. This is not true and incorrect. The auditor’s report should be for the directors and also for the public, and this calls into question the seriousness that should be attached to it by auditors.

The auditor’s responsibility is one vehicle that will assure the public that the auditors were independent of directors and therefore his report can be relied upon. This independence is

to give users of financial statement information to assist them in assessing auditor independence. Many interested partners before now did not believe that such independence disclosures would significantly impact on the audit function. This could have informed the peat Marwick case. There were many issues on auditor's responsibility that were unanswered. But the bankruptcy on December 2, 2001, of Enron which at the time, was the largest bankruptcy in the United States history has now call to question the independence of Enron auditors (Author Anderson & co) since Enron auditors had previously issued unqualified opinion on Enron's financial statements (Bymes et al (2002). Does the auditor's independence impact on their responsibility? The answer is yes. The issue was that the auditor (Author Anderson & co) had allowed their interest in Enron to blur their independence and responsibility (Bymes et al 2002). The auditor responsibility does not only go to the users of the report but also to the auditor him/herself and the profession where he refuses to act on his responsibility, this may spell doom to the whole audit firm as in the case of Enron and Author Anderson or may lead to flurry of law suits which goes a distance to affect accounting profession in general and auditing in particular.

Elements of Auditors Independence

The financial principles of accountant's ethical code of conduct are summarized to include competence, confidentiality, integrity, objectivity, and independence which is the life wire of the auditing profession. Defined by international federation of Accountants Committee (IFAC), education committee, professional ethics is the professional/behaviour and characteristics that identify professional accountants as members of a profession. They include the principles of conducts, (i.e. ethical principles) generally associated with and considered essential in defining the distinctive characteristics of profession behaviour. Where these standards are breached, compromised or not property applied, impairment or compromise may likely result. Areas where auditors' independence may be subjected to conflict of interest that may impair audit functions are as identified by David (1982), which include

- Where auditors receive gifts and free services from the client could affect his independence especially where the value of the financial gift or services are high.
- Where the audit fees from a single audit assignment of client's well constitute a significant proportion of the total amount of loss income of the practice, up to 25% of the annual gross income will be consider material and may create undue influence on the part of the auditor.
- Where the auditor is closely related to the directors of the company, either by blood or marriage, this could surely affect the auditors independence.

- In a situation where the auditor or members of his family has substantial holding in the shares of the client company. This could affect the auditor's independence since this may result in joint ownership of the business.
- Advising two opposing clients: The auditor could find himself in a position where he has to advice two opposing client's competing for a single contract. Except he is able to reject one of the two, (which may not be possible), he may not be able to maintain integrity as he may be in support of one client more than the other.
- Independence of an auditor could be affected where he gives or receives loan from a client company especially if loan granted is not the primary nature of the clients business.
- An auditor is in a privilege position to have access to the financial records or the secrets of the company's affairs. Such position would be abused if the auditor discloses any of such information to third party, without any legal obligation to do such. This would without doubt affect his integrity.

Aguolu (2002) further stated that the auditor in order to maintain and protect his integrity and independence in his relationship with the directors and staff of his clients must make sure that he is free to think the way he chooses, to ask whatever questions or make any observations he considered appropriate without any underlying fear of being misunderstood or misinterpreted. So the auditor must be professionally independent, of his client on whom he forms his opinion and should be careful not to compromise his independence as stated in the different sections of CAMA 1990. A study of the section of the act reveals clearly the conscious attempt being made to protect the independence of auditors.

The Need for an Independent Auditor in our Organizations

Our organizations need auditor and vice versa. The work of an auditor is absolutely necessary in every organization. The managements are not the owners of the company. They are only managing in trust for the real owners who may be the shareholders in the case of public liability company. The directors represent the interest of the shareholders. And it is the directors that appoint the auditor to examine, certify and critically review the reports of the company as represented by the financial statement. The duty of the auditor is to accord the financial statement a legal status by expressing a true and fair opinion on the financial statement so presented. Furthermore, this would enhance the shareholders believe in the policies and operations of management. The financial statement has to be fair in both fact and appearance. This is to allay the fears of the shareholders that their investment had been judiciously

managed. In view of the above it is clear that the auditor is independent of management but he is only engaged to carry out a professional duty. Independence entails the fact that he is not a part of accounts preparation process.

The above view is in line with that expressed by the US Securities and Exchange Commission (SEC, 1979) and the “SARBANES-Oxley Act” (2000) which contends that an auditor cannot objectively audit books and records which he has maintained for the client. This service, the SEC agreed places the auditor in a position of evaluating and attesting to his own record keeping. Okike (1983) as cited by Odo (2003) also argued that it is doubtful if the auditor can realistically be independent when he is judging and giving an opinion on accounting information he may have helped to install.

Management Influence

Management influence in relation to audit is the process where the auditor cannot carry out his auditing work creditable but based his judgement on the condition, perception, feeling and mode of the management and client. This is to say that the auditor has to bend the rules of auditing to suit what the management has done or intend to do. Management influence may be referred to as a systematic misrepresentation of the true income and assets of the corporation. It could also be construed as window dressing of accounts, cooking of accounts, creating of figures or manipulating of figures being reflected in financial statement. This goes to vindicate the CBN governor, Mr. Sanusi Lamido Sanusi when he accused the banks management of influencing the financial statement thus, “I will fire any bank CEOs that “cook the books”. Management influence generally is when managements allow the auditor to see only what they would want him to see and further than that management influence can be psychological, systematic and economical.

Types of Management Influence

One of the major areas that management can influence auditors is in the area of non-audit duties. Barker and Simhett (1992), Hillison and Ihenedy (1988), Palmrose (1986), have investigated the economic effects of non audit function to the client and management of companies and found that non audit functions, depending on the amount involved, do have negative economic effect on auditor independence. It is almost a normalcy for an auditor to also be a consultant on such matters, as tax and management services to the same company, Appah (2011) has warned that when audit and non audit services are provided to the same client the provider needs to be careful not to jeopardize their independence because there are occasions where independence may be threatened or appear to be threatened by the provision

of services other than audit. Where does the auditor draw the line? The answer is in the Rules of Professional conducts for members of the chartered accountant of Nigeria (ICAN), “members may provide these services without basically affecting the independence, in the provision of statutory audit”. This is confirmed by the studies of Ghosh and Kallapur (2006). This in the opinion of this researcher may not be enough because an auditor is an economic being and may not be able to resist the influence of management. This is supported by Frankel et al (2002), Brandon et al (2004).

Another area that management can influence the independence of an auditor is in the area of earnings management. According to Ugbe, (2010) earnings management involves the artificial increase (or decrease) of revenue, profit or earnings per share figures through aggressive tactics. Aggressive earnings management is a form of fraud and differs from reporting error. Management wishing to show earnings at a certain level or following a certain pattern seek loopholes in financial reporting standards, that allow them (management) to adjust numbers as far as it is possible, to achieve that desired aim or to satisfy projections by financial analyst. It is relatively easy for an auditor to detect error, but earnings management can involve sophisticated fraud that is covert. The requirement for management to assert that the financial statements have been prepared properly offers no protection where those managers have already entered into conscious deceit and fraud.

This is what the CBN audit team uncovered in the recently recapitalized banks, when it decided to audit their books. Sanusi Lamido Sanusi (2009) in his address to the annual conference of the ICAN in Abuja, Nigeria said that, Nigerians would be startled when the sacked CEOs are confronted with the details of their acts in court. He then asked the accountant rhetorically, “While these were happening”, where were the accountants and auditors? He went on to say that someone was reporting profits, paying dividends out of operations that could not by any standard be said to be profitable. He concluded by saying “That is why we are where we are”.

Marginal loan is another area of earnings management that management can deploy to influence the independence of an auditor. Marginal loans are loans advanced to investors for the purpose of buying securities. The so called investors are at times directors who engaged the auditor. According to Sanusi of the CBN, the five banks whose chief executives were removed had total loan portfolio of N2.8 trillion, out of which margin loans account for N456.2 billion. These loans may have securities on paper but not in real situation. The auditor is only working on what he sees. Documents. To plug this loophole the CBN has directed for the full disclosure on financial statement of banks which according to the CBN is to restore order and

professionalism. The CBN governor has also made it an offence for banks to advance loans without assessing the credit worthiness of the customer.

Ahmed, (2009) in an essay entitled “Banks: one crisis too many”, A general overview of the role of Directors and Auditors” stated that bad loans and advances were among the major causes of bank distress in Nigeria. Winifred Iyiegbuninue, professor of finance at the University of Lagos, said such loans could only be approved at board’s level and in most cases for their cronies without adequate collateralization.

Insider loans are one area of influence on auditors. This forms another area of earnings management. Insider loans are loans granted to management and directors and this may be granted without adequate security. Where this is the case the loans would be so managed in order to evade the scrutiny of the auditor. According to News watch magazine of 24th August, 2009, insider loans contributed to the killing of over 13 banks that could not recapitalized in 2005. Insider loan abuse according the Nigerian senate totaled N53.3 billion while depositors of failed banks are said to be owed N 188 billion.

To check these influence of managements mostly in the Nigerian banking system, the CBN has directed that December 31st of every year be the uniform banking year for all banks taking effect from 2009. This was to check phony results posted by banks. On the part of the auditor, Ugbe (2010) cautioned, Auditors need to distinguish fraud from error by identifying the presence of intention.

Agency relationship is another type of management influence. This is a situation where the management is separated from the owners of the business. In this case, there is pressure on management to report impressive results to shareholders and other interest groups. Under Agency theory, cost not ethics provides the only restraint on the self interest behaviour of the agent. Since agents in this situation are constraint to impress investors and lenders who are interested in high profit. The agents are compelled to give an impressive report against their ethical values. This relationship was originally set out by Alchian and Demsetz, (1972) and extended by Jensen and Meckling (1976).

Causes of Management Influence

The major cause of management influence is to report high earnings which in turn translate into goodwill both from the shareholders and the regulatory authorities. This is what earnings management is all about. According to Healy and Wahlen (1999), ‘earnings management’, occurs when managers use judgment in financial reporting and in structuring transactions to alter financial reports to either mislead some stakeholders about the underlying economic performance of a company or influence contractual outcomes that depend on reported

accounting numbers. Financial statement was to be prepared and presented in a true and fair manner that is in consonant with the Generally Acceptable Accounting Principles (GAAP). The auditor was to express an opinion on the financial statement as to the fairness in fact and in appearance. It was not an avenue to “cook the books” and deceive every stakeholder.

Stewardship and Resource allocation conflict: investors require impressive results of constant growth of a company in order to show for the committed resources and possibly to commit more. In this case, managers and directors are enticed to adjust and give flattering results to reflect steady growth in order to obtain appreciation and goodwill from investors. This in a modern parlance in accounting is called “creative accounting”. This, to this researcher is fraud, because they are supposed to report on the actual performance no matter how unstable and unflattering the results might be. This is what happened in Oceanic Bank Plc. This researcher ran into a shareholder of the bank who confessed that he invested about N2 million in 2005 in the stocks of Oceanic Bank and up to the time this research work is being carried out in 2011, according to him, “not even a dime has been paid to him as dividend”. Very sad. This is the bank that was declaring profit at the end of every financial year. The question this researcher might ask is, “where did they get all the figures to declare as profit and did not have all the figures to pay dividend”. This is to confirm what the CBN governor, Mr, Sanusi Lamido Sanusi of the CBN said that Bank Directors in Nigeria “cook the books” of accounts. This researcher has nothing personal against any of the five recapitalized banks, but the truth must be told. These banks were involved in the same thing “influence peddling”. The CBN governor while addressing members of the Nigerian senate in October, 2009, said the sacked CEOs were reckless credit managers. He said that Mrs Ibru (the Oceanic Bank CEO) owned two private jets and had paid for two more before she was removed from office. He went on to reveal that the CEO granted N 235 billion loans to some family members. Mr Sanusi went on to question this given that the bank’s capital base was N 300 billion. Where does the blame for the auditor comes in here?, when he is dealing with a powerful and overbearing chief executive officer.

Acts of management influences like this led to the near collapse of the five banks which necessitated the CBN to inject N420 billion funds into them in 2009, and the assurance that it would guarantee the liabilities of the affected banks. Prior to the injection of fresh capital into these banks the CBN governor had supervised two major audit reports. The reports had not only exposed the fragile nature of the sector, but also laid bare how some directors ran their banks with little or no regard to rules and regulations. At the end of the exercise, according to Onabanjo (2009), 10 banks were found to have eaten up their capital base through loans that lacked adequate security. This is what an influential and overbearing management can result to.

RESEARCH METHODOLOGY

The Study

An attempt was made in this study to examine the extent of management influence on auditor's independence. The design of the study is the basic plan which guides the data collection, presentation and analysis phase of the research project. It is the framework which specifies the type of information to be collected, the source of the data and the data collection procedures to be adopted by a researcher (Asika, 2003). This study made use of a survey research design.

Data & Data Collection Tool

The data collected from the selected sample described the nature, characteristic and experience of the universe or population, as well as examining the affects between variables in the study. The population of the study consists of all the commercial banks trading on the floor of the Nigerian Stock Exchange (NSE). The sample size of five (5) commercial banks was selected based on a judgmental sampling technique.

According to Balsely and Clover (1988), it is common in research studies to use 10 percent sample size, because sample size of 10 percent of the universe has been proved to be more than adequate in research projects. Ogolo (1996) corroborates this when he posits that where a population is known, at least 10 percent of it constitutes a researchable sample. For this study five (5) commercial banks were selected, amounting to 24% of the universe.

The data gathering method explained in this sub section includes: data sources (primary and secondary) and methods of data collection. The data collected for this study were both primary and secondary. This consists of raw data obtained from the questionnaire and personal interview. The data for this study was gathered using questionnaire and personal interview. The questionnaire was administered personally by the researcher. Copies of the questionnaire were then distributed to the randomly selected sample commercial banks. Out of the forty (40) questionnaires distributed only thirty one (31) were actually received constituting 77.5%.

Personal interview was conducted as a complement of the questionnaire. The interview was meant to help fill in information that was left out by the respondents in the questionnaire. The researcher obtained secondary data from textbooks, journals, magazines, Nigerian Stock Exchange (NSE) fact-book and annual reports.

Validity and Reliability of the Research Instrument

To ensure content validity of the instrument used, the items on the questionnaire were drawn up and given to experts in research, Faculty of Management Sciences for checking. It was absolutely necessary to determine whether the items measured what they were supposed to

measure. In most cases except for a few, the statements were straight forward and important. However, those that tended to be ambiguous were deleted. A few mechanical errors were identified and corrections were made by the supervisor before it was administered.

To establish the reliability of the instrument the researcher carry out a trial testing using some respondents randomly selected from the left over manufacturing companies which were not part of the sampled of the study. The instrument (questionnaire) was administered to these respondents to fill and the questionnaire retrieve and analyze.

Model Specification

The regression model for the study is expressed below as thus:

$$\text{AUD.Q} = f(\text{NAD}, \text{EM}, \text{ML}, \text{IL}, \text{AR})$$

Mathematically stated as:

$$\text{AUD.Q} = \beta_0 + \beta_1\text{NAD}_1 + \beta_2\text{EM} + \beta_3\text{ML} + \beta_4\text{IL} + \beta_5\text{AR} + \mu$$

Where:

AUD.Q = Audit Quality

NAD = Non audit duties

EM = Earnings management

ML = Marginal Loan

IL = Insider Loan

AR = Agency Relationship

β_0 = Unknown constant to be estimated

$\beta_1 - \beta_5$ = Unknown coefficients to be estimated

u = Stochastic error term

Techniques of data treatment

The study adopted the inductive and empirical methodological framework. After collection of the data from the questionnaire, the data was tabulated and statistically analysed using the Ordinary Least Square (OLS) analytical technique. As it is well known that the OLS method is the best to use for the prediction. However, the method is criticized for inability to account for feedback effect of the explanatory variables.

All the equations were estimated using the OLS techniques, the signs of the regression coefficients were checked to see if they are in line with a priori economic prescriptions.

ANALYSIS & EMPIRICAL RESULTS

Table 1: Regression results on management influence and auditor's independence

VARIABLE	ESTIMATED COEFFICENTS	STANDARD ERROR	T-Statistic	P- Value
Constant	41.563	11.186	3.716	.001
NAD	-.188	.026	-7.275	.000
EM	-.190	.032	-5.983	.000
ML	-.120	.027	-4.500	.001
IL	-.387	.058	-6.702	.000
AR	-.233	.043	-5.447	.000
R	=	0.935		
R-Square	=	0.874		
Adjusted R-Square	=	0.841		
SEE	=	3.99581		
F – Statistic (df ₁ = 5 & df ₂ =25)	=	12.883 (p .000)		
Durbin Watson Statistic	=	2.027		
t-statistics (table value) at 5% two tail	=	2.04		
DEPENDENT VARIABLE: Audit Quality (AUD.Q)				

Table shows the regression results on management influence and auditor's independence. The independent variable management influence is mirrored by Non Audit Duties (NAD), Earnings Management (EM), Marginal Loan (ML), Insider Loan (IL) and Agency Relationship (AR) while the dependent variable is also mirrored by Audit Quality (AUD.Q).

The regression results showed that the estimated coefficient of the regression parameters have negative signs and thus conform to our economic a priori theory. The implications of these signs are that the dependent variable audit quality is negatively influenced by Non Audit Duties (NAD), Earnings Management (EM), Marginal Loan (ML), Insider Loan (IL) and Agency Relationship (AR). This means that an increase in the independent variables will bring about a poor qualified report.

The coefficient of determination R-square of 0.874 implied that 87.4% of the sample variation in the dependent variable is explained or caused by the explanatory variables while 12.6% is unexplained. This remaining 12.6% could be caused by other factors or variables not built into the model. The high value of R-square is an indication of a good relationship between the dependent and independent variables.

The value of the adjusted R^2 is 0.841. This shows that the regression line captures more than 84.1% of the total variation in corporate productivity caused by variation in the explanatory variables specified in the equation with less than 15.9% accounting for the error term.

Testing the statistical significant of the overall model, the f-statistic was used. The model is said to be statistically significant at 5% level because the F-statistics computed of 12.883 is greater than the F-statistic table value of 2.60 at $df_1=5$ and $df_2=25$.

The test of autocorrelation using D/W test shows that the D/W value of 2.027 falls within the inconclusive region of D/W partition curve. Hence, we can clearly say that there exists no degree of autocorrelation.

DISCUSSION OF FINDINGS

Based on the analysis and empirical results, the study revealed that all the estimated coefficients of the regression parameters have negative signs and thus conform to our economic a priori theory. The implications of these signs are that the dependent variable audit quality is negatively influenced by Non Audit Duties (NAD), Earnings Management (EM), Marginal Loan (ML), Insider Loan (IL) and Agency Relationship (AR). This means that an increase in the independent variables will bring about a poor qualified auditor's report.

Specifically, a 1% increase or decrease in management influence mirrored by Non Audit Duties (NAD), Earnings Management (EM), Marginal Loan (ML), Insider Loan (IL) and Agency Relationship (AR) would lead to poor qualified auditor's report with a margin of approximately -0.188, -0.190, -0.120, -0.387 and -0.233 respectively.

The study revealed that, management influence has a significant negative influence on auditor's independence. This result is in line with the work of Lennox and Park (2007) who found out that management affiliations (i.e. Non Audit Duties (NAD), Earnings Management (EM), Marginal Loan (ML), Insider Loan (IL) and Agency Relationship (AR) have a significant impact on audit quality.

CONCLUSION AND RECOMMENDATIONS

The role of the auditor has evolved from fraud detection to expressing of opinion on the truth and fairness of financial statements. It has been observed that firms including banks in Nigeria have gone insolvent with clean audit reports; when legislation requires the auditor to qualify his opinion if he is of the view that the enterprises is unlikely to continue as a going concern. This legislation has become outdated and the basic grounds rules of our political system have prevented necessary legislative reform, this faulty legislative system has institutionalized a corrupt set of structures and these structures lead to biased decisions and occasionally outright corruption. Current laws have created an insufficient, unethical and wasteful system. This system is where Accounting and auditing find themselves. This no doubt raises question as to what extent a third party such as investors may place reliance on the auditors' report. The whole

area of auditors negligence is worthy of investigation and this researcher can only conclude to the lack of research into the judgmental processes used by audit partners in coming to a qualified report and where independence come into question.

The study was set out to study management influence and its influence on auditor independence. Having identified some of the causes, the study then makes the following recommendations:

1. There is an urgent need to reform the audit profession through legislations.
2. The federal government can push the independent financial reporting council bill through the legislature into law. This body may be likened to public company accounting oversight board (PCAOB) in the United States to oversee the audit of public companies. As part of it functions, the Board should register audit firms, quality control, punishment, ethical and other standards relating to the preparation of audit reports, conduct investigations disciplinary proceedings concerning violations of financial security laws and ensure independent of auditors, unlike the current situation where this is left to the individual professional bodies of accounting in Nigeria – ICAN and ANAN. There should be mandatory rotation of external auditor for at least three or four year tenure. This will reduce the level of familiarity of auditors with clients' management and staff. This will go a distance to reduce the dominance of the big audit firms and encouraged the smaller ones to grow.
3. In addition, external auditing firms should be prohibited from providing certain non-auditing services especially those linking them directly to financial information and design, internal control, tax consultancy etc alongside auditing functions. There should be a law to this effect.
4. Finally, the accounting professional bodies should team up and establish a monitoring system or mechanism to lead the crusade on transparency and accountability in reporting.

SUGGESTIONS FOR FURTHER RESEARCH

In appraising this study's findings, interested persons are advised to keep in view the following observations and limitations. First, research in other geographical settings is also clearly warranted to see how generalizeable/divergent results are. Also, on the methodological constraint, this study basically made use of the Ordinary Least Square (OLS) method. With its theoretical weaknesses, it is suggested that other sophisticated data treatment techniques such as co-integration, path analysis and Error Correction Modeling (ECM) be use. The ECM will make the regression analysis free from any spuriously generated results.

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