

**THE DEVELOPMENT OF AUDITOR INDEPENDENCE
DIMENSIONS: NIGERIAN STAKEHOLDERS'
PERSPECTIVE**

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STAKEHOLDERS' PERSPECTIVE**

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ABSTRACT

Past studies on auditor independence (AI) generally focused on factors influencing AI by examining individual or group of factors posited to impact AI using various proxies of AI. Since regulatory frameworks define AI along two dimensions (fact and appearance), the use of proxies such as non-audit fees ratio, audit to total fees ratio or client importance is insufficient, because of their inability to capture both dimensions of AI. The study investigated the concept of AI and developed a measure for AI based on Nigerian stakeholders' perceptions. The first phase investigated the constituents of AI and how they interdependently measure AI. Data was collected from 233 stakeholders comprising practising accountants, bank loan officers, members of the corporate governance body, Financial Reporting Council officers, officers of the Federal Inland Revenue Service and shareholders, using disproportionate stratified sampling. Results from exploratory and confirmatory factor analysis showed that the AI measure consisted of nine constructs (perceived objectivity, perceived integrity, perceived professional skepticism, self-interest threat avoidance, self-review threat avoidance, familiarity threat avoidance, intimidation threat avoidance, advocacy threat avoidance and safeguards implementation). The second phase examined the applicability of the measure among financial directors of listed companies. Data collected from 62 financial directors of listed companies in Lagos was analyzed using Partial Least Squares Structural Equation Modelling. Results showed that the measure was valid, reliable and applicable in Nigeria. The study contributes to by proposing and operationalizing a holistic measure for AI. It also confirms the existence of a hierarchical model explaining AI in terms of its two dimensions. (Independence in fact and appearance) as measured by nine constructs. The study contributes theoretically, methodologically and practically to the body of knowledge and has implications to regulators, auditors and other researchers. It will benefit regulatory and professional bodies in assessing and structuring auditor independence standards, provides an assessment tool for auditors and an avenue for further research for academics.

Keywords: Independence in Fact, Independence in Appearance, Threats Avoidance, Safeguards Implementation, Auditor Independence

ABSTRAK

Kajian lepas mengenai kebebasan juruaudit (KJ) secara umumnya tertumpu kepada faktor-faktor yang mempengaruhi KJ dengan menyelidiki faktor individu atau kumpulan yang diandaikan memberi kesan terhadap KJ melalui pelbagai proksi. Disebabkan rangka kerja kawal selia mengenal pasti KJ dalam dua dimensi (hakikat dan rupa), penggunaan proksi seperti nisbah yuran bukan audit, nisbah audit kepada jumlah yuran atau kepentingan pelanggan tidak mencukupi kerana ia tidak berupaya menggambarkan kedua-dua dimensi ini. Kajian ini menyiasat konsep KJ dan membangunkan penilaiannya berdasarkan persepsi pihak berkepentingan di Nigeria. Fasa pertama menyiasat konstituen KJ dan bagaimana ia menilai KJ. Data dikumpul menerusi 233 pihak berkepentingan daripada pengamal perakaunan, pegawai pinjaman bank, ahli-ahli badan tadbir urus korporat, pegawai-pegawai Majlis Laporan Kewangan, pegawai-pegawai Persekutuan Perkhidmatan Hasil Dalam Negeri dan pemegang saham menggunakan persampelan berstrata tidak seimbang. Keputusan analisis faktor penerokaan dan pengesahan menunjukkan penilaian KJ terdiri daripada sembilan konstruk (anggapan objektiviti, anggapan integriti, anggapan keraguan profesional, pengelakan ancaman demi kepentingan sendiri, pengelakan ancaman melalui cermin sendiri, pengelakan ancaman kebiasaan, pengelakan ancaman ugutan, pengelakan ancaman sokongan dan perlindungan pelaksanaan). Fasa kedua menyiasat kebolegunaan penilaian di kalangan pengarah kewangan syarikat yang tersenarai. Data daripada 62 pengarah kewangan syarikat yang tersenarai di Lagos dianalisis menggunakan Model Persamaan Struktur Separa Kuasa Dua Terkecil (*Partial Least Squares Structural Equation Modelling*). Hasil kajian menunjukkan penilaian KJ adalah sah, boleh dipercayai serta boleh digunakan di Nigeria. Kajian ini menyumbang kepada khazanah ilmu dengan mencadangkan dan mengoperasikan penilaian KJ yang holistik. Ia juga mengesahkan kewujudan model hierarki yang menjelaskan KJ dari dua dimensi (hakikat dan rupa) seperti dinyatakan oleh sembilan konstruk. Kajian ini menyumbang secara teoritikal, metodologi dan praktikal terhadap khazanah ilmu serta memberi kesan kepada pembuat undang-undang, juruaudit dan penyelidik. Ia bermanfaat kepada pembuat undang-undang dan badan profesional dalam menilai dan menstruktur standard kebebasan juruaudit, sebagai alat pengukuran juruaudit dan menyediakan landasan bagi ahli akademik menjalankan penyelidikan lanjutan.

Kata kunci: Kebebasan Sebenar, Kebebasan dalam Penampilan, Pengelakan Ancaman, Pelaksanaan Perlindungan, Kebebasan Juruaudit

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LIST OF ABBREVIATIONS

| | |
|-------|--|
| AI | Auditor Independence |
| AICPA | American Institute of Certified Public Accountants |
| AMOS | Analysis of Moment Structures |
| ANAN | Association of National Accountants of Nigeria |
| ATA | Advocacy Threat Avoidance |
| AVE | Average Variance Extracted |
| CAMA | Company and Allied Matters Act |
| EFA | Exploratory Factor Analysis |
| FIRS | Federal Inland Revenue Service |
| FRCN | Financial Reporting Council of Nigeria |
| FTA | Familiarity Threat Avoidance |
| IAS | International Auditing Standards |
| ICAN | Institute of Chartered Accountants of Nigeria |
| IFAC | International Federation of Accountants |
| IIA | Independence in Appearance |
| IIF | Independence in Fact |
| ITA | Intimidation Threat Avoidance |
| IOD | Institute of Directors |
| NAS | Non-audit Services |
| PAF | Principal Axis Factoring |
| PAI | Perceived Auditor Independence |
| PCA | Principal Component Analysis |

| | |
|----------------|---|
| PI | Perceived Integrity |
| PLS | Partial Least Squares |
| PPS | Perceived Professional Skepticism |
| PO | Perceived Objectivity |
| Q ² | Construct Cross-Validated Redundancy |
| R ² | R-squared Values |
| SAS | Statements of Accounting Standards |
| SEC | Security and Exchange Commission |
| SEM | Structural Equation Modelling |
| SIA | Safeguards Implementation Assessment |
| SITA | Self-interest Threat Avoidance |
| SRTA | Self-review Threat Avoidance |
| SOX | Sarbanese Oxley Act |
| SPSS | Statistical Package for Social Sciences |
| USA | United States of America |
| UK | United Kingdom |

CHAPTER ONE

INTRODUCTION

1.1 Background of Study

The relevance of the audit function stems from the need to enhance the credibility and reliability of financial reports by providing reasonable and objective assurance that the financial reports reflect the true state of affairs of a business. Thus the professional codes require auditors to be independent both in fact and appearance in the conduct of audit assignments. Because independence in fact is difficult to observe, shareholders and other users of financial statements assess the auditor's appearance of objectivity by considering whether circumstances that impair Audit Independence (AI) exist. These may include existence of financial interests, business or employment relationships, length of engagement, provision of Non Audit services (NAS) client importance or gift relations.

Financial markets, shareholders, potential investors, creditors and analysts rely heavily on audited financial reports to make investment decisions. Without such trust and perceived integrity, audit reports become valueless to decision makers (Alleyne, Devonish & Alleyne, 2006). Quick and Rasmussen (2009) contend that perceptions of independence significantly influence capital market efficiency. This is because if auditors are perceived to lack independence, shareholders will demand higher returns due to higher risks borne which inadvertently increases cost of capital, deters investments and overall disrupts capital market efficiency.

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